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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,
Respondents.

A.G. BECKER INCORPORATED,
Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,
Respondents.

APPENDIX TO JOINT PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA CIRCUIT

Nos. 80-2258, 81-2070, 81-1493, 81-2058,
81-2096 and 80-2314

Argued 3 June 1982
Decided 2 Nov. 1982
As Amended Nov. 2, 1982

A.G. BECKER INCORPORATED,
Petitioner-Appellee,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,
Respondents-Appellants.

SECURITIES INDUSTRY ASSOCIATION,
Petitioner-Appellee,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,
Respondents-Appellants.

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Richard M. Ashton, Washington, D.C., with whom Michael Bradfield, Washington, D.C., was on the brief for Bd. of Governors of the Federal Reserve System, et al., appellants Nos. 81-2058 and 81-2070 and appellants/respondents in Nos. 80-2258, 80-2314, 81-1493 and 81-2096, James V. Mattingly, Jr., Washington, D.C., also entered an appearance for the Bd. of Governors of the Federal Reserve System, et al.

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Charles F.C. Ruff, U.S. Atty., Royce C. Lamberth, Kenneth M. Raisler, William H. Briggs, Jr., Asst. U.S. Attys., Washington, D.C., also entered an appearance for appellee/respondent in No. 81-1493.

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Leonard H. Becker, Steven A. Musher and Joseph McLaughlin, Washington, D.C., entered appearances for Goldman, Sachs and Co., amicus curiae in Nos. 80-2314, 81-2058, 80-2258, 81-1493, 81-2096 and 81-2070.

Paul Gorson and Russell Stevenson, Washington, D.C., entered appearances for Securities and Exchange Com'n, amicus curiae in Nos. 81-2096 and 81-2058.

Before TAMM and WILKEY, Circuit Judges and ROBB, Senior Circuit Judge.

Opinion for the Court filed by Circuit Judge WILKEY.

Dissenting opinion filed by Senior Circuit Judge ROBB.

WILKEY, *Circuit Judge*:

This case calls upon us to decide whether the Federal Reserve Board acted lawfully in permitting the Bankers Trust Company, a state member bank of the Federal Reserve System,[1] to act as agent in the sale of commercial paper. After Bankers Trust began marketing commercial paper, A.G. Becker, Inc., a broker-dealer in securities, and the Securities Industry Association ("SIA"), an organization representing over five hundred securities brokers and dealers, requested the Board to declare Bankers Trust's activities illegal and to bring appropriate enforcement action. Becker and the SIA contended that Bankers Trust was in violation of sections 16 and 21 of the Glass-Steagall Act ("the Act"), which prohibit commercial banks, with certain exceptions, from buying, selling, or underwriting "securities."[2] The Federal Reserve Board determined, however, that the commercial paper marketed by Bankers Trust

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1 *See* 12 U.S.C. §§ 321-339 (1976 & Supp. IV 1980).

2 Section 16 of the Act provides in pertinent part:

> The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock; *Provided*, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe.

12 U.S.C. § 24 Seventh (Supp. IV 1980).

Section 21 provides that:

> [I]t shall be unlawful . . . [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor. . . .

12 U.S.C. § 378(a)(1)(1976).

was not a "security" within the meaning of the Act.[3] Becker and the SIA then brought suit in the district court, which held the Board's determination to be invalid.[4] The Board appealed, and we reverse.

I. FACTS

"Commercial paper" refers to prime quality, negotiable promissory notes bearing very short maturities—generally 30 to 90 days.[5] Large, financially strong corporations use commercial paper to obtain funds for current needs. Commercial paper is sold, in denominations averaging one million dollars or more, to large, sophisticated purchasers—money market mutual funds, bank trust departments, insurance companies and pension funds.[6]

Bankers Trust began placing third party commercial paper in 1978.[7] Its issuers had the highest rating from at least one of the rating services for commercial paper issuers; its customers were part of the bank's established base of institutional investors, who regularly purchase short term instruments from the bank. The bank offered to act as financial adviser to issuers of paper sold by the bank, and to extend credit to them, though for only

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3 Federal Reserve System, Statement Regarding Petitions to Initiate Enforcement Action (26 Sept. 1980), Joint Appendix (J.A.) at 220 [hereinafter cited as Federal Reserve Statement].

4 *A.G. Becker, Inc.* v. *Board of Governors*, 519 F. Supp. 602 (D.D.C. 1981).

5 *See generally* Hurley, *The Commercial Paper Market*, 63 Fed. Res. Bull. 525 (1977); Comment, *The Commercial Paper Market and the Securities Acts*, 39 U. Chi. L. Rev. 362 (1972).

6 *See* sources cited at *supra* note 5. *See also infra* p. 149 [26a].

7 This description of Bankers Trust's activities relies upon Federal Reserve Statement, *supra* note 3, at 2-3, J.A. at 221-22. Appellees do not challenge the Board's factual findings as to Bankers Trust's participation in the commercial paper market.

a small portion of the unsold amount of the issue. It did not commit itself to purchase unsold paper, but it did purchase in the secondary market commercial paper of issuers for which it had acted. Bankers Trust was the first commercial bank to enter the commercial paper market in competition with the investment banks; other commercial banks awaited the outcome of subsequent legal proceedings.

Becker and the SIA requested the staff of the Federal Reserve Board to review the legality of Bankers Trust's activities. The Board's general counsel, after extensive discussion with Becker, SIA, Bankers Trust and the SEC, issued an opinion declaring that commercial banks may lawfully act as agent for the issuer in the sale of commercial paper, "provided that the sales . . . are limited to purchasers to whom commercial banks normally sell participations in loans."[8] Becker and the SIA then requested the Federal Reserve Board to review the decision of its general counsel and to proscribe the commercial paper activities of member banks. After considering submissions by interested parties and conducting an on-site investigation of Bankers Trust's activities, the Board ruled that Bankers Trust's participation in the commercial paper market did not violate the Glass-Steagall Act or contravene public policy.[9]

In a carefully reasoned opinion the Board first concluded that there was no indication in the language or legislative history of the Glass-Steagall Act that Congress considered commercial paper to be a "security," in which banks were forbidden to deal.[10] The Board noted that banks had traditionally traded in commercial paper, and that the Act had been intended to strengthen banks in the exercise of traditional banking functions. The Board then turned to a "functional" analysis of the statutory terms, and concluded that, because

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8 Legal Division, Board of Governors of the Federal Reserve System, Commercial Paper Activities of Commercial Banks: A Legal Analysis 21 (28 June 1979), J.A. at 168.

9 Federal Reserve Statement, *supra* note 3.

10 *Id.* at 6-17, J.A. at 225-36.

commercial paper embodies short-term loans from a few sophisticated lenders to financially strong borrowers, it resembled a loan rather than a security for the purpose of the Glass-Steagall Act.[11] Because the Board ruled that commercial paper was not a "security," it did not reach the issue whether Bankers Trust was "issuing, underwriting, selling, or distributing" securities within the meaning of the Glass-Steagall Act.[12]

Subsequently, the Board issued guidelines to ensure that sale of third party commercial paper did not give rise to "unsafe or unsound practices."[13] These guidelines permitted banks to sell only prime quality third party commercial paper with maturity of nine months or less and in denominations of over $100,000. Banks could sell only to "financially sophisticated customers," and were forbidden to advertise to the general public. Sales to the bank's fiduciary accounts, parent holding companies and nonbank affiliates were also forbidden. Moreover, banks were required to maintain credit analyses of issuers, to limit the amount of paper sold for any issuer, and to maintain detailed records of sales, purchases and lines of credit extended. Finally, various disclosure requirements were imposed.

SIA and Becker sought review in the district court of the Board's ruling that commercial paper was not a "security." That court concluded that the Act's "plain language" barred commercial banks from trading in commercial paper.[14] It also found that the "broad framework" of the Act evinced Con-

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11 *Id.* at 17-20, J.A. at 236-39. The Board also rejected the arguments that the definition of "security" in the Securities Act of 1933, or considerations of public policy, militated against permitting Bankers Trust's sale of third party commercial paper. *Id.* at 20-27, J.A. at 239-46.

12 *Id.* at 24, J.A. at 243.

13 Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks, 46 Fed. Reg. 29333, 29334-35 (26 May 1981) [hereinafter cited as Guidelines].

14 *Becker*, 519 F. Supp. at 612-13.

gress' intent to institute a sweeping prohibition of commercial banks' engaging in investment banking activities.[15] Finally, in response to the Board's "functional" analysis of commercial paper, the court averred that "[o]ne factor . . . compels the conclusion that the commercial paper at issue here is [a security], and that crucial aspect is the role of Bankers Trust in the transaction."[16] For these reasons, the district court issued a declaratory judgment that the Board's ruling was contrary to law.[17]

We reverse. The district court gave insufficient weight to the expertise of the Federal Reserve Board—as the agency responsible for administering the nation's banking system—in interpreting the provisions of the Glass-Steagall Act. Moreover, the language of the Act, its legislative history and the policies underlying it all support the Board's conclusions that commercial paper is not a "security" under the Act. We discuss each of these findings in turn.

II. STANDARD OF REVIEW

The Supreme Court recently had occasion again to delineate the standard to be applied in the review of an agency's interpretation of a statute which it is charged to implement.

15 *Id.* at 614-15.

16 *Id.* at 615-16.

17 *Id.* at 616. The district court confined its holding to the question of whether the commercial paper at issue was a "security." Like the Board, it did not reach the question whether Bankers Trust was "underwriting" securities in violation of the Glass-Steagall Act. *See id.* at 616 n. 10.

Moreover, the district court did not explicitly rule on the validity of the Board's guidelines. However, because the guidelines in essence describe Bankers Trust's activities, it would be difficult to reconcile those guidelines with the district court's holdings. Conversely, if we find that Bankers Trust has acted lawfully, the activities of other commercial banks in compliance with the guidelines would be lawful as well. *See* Part IV (Conclusion) *infra*.

The task of the reviewing court is "not to interpret the statute as it [thinks] best but rather the narrower inquiry into whether the [agency's] construction was '*sufficiently reasonable*' to be accepted by a reviewing court. . . . To satisfy this standard it is not necessary for a court to find that the agency's construction was the only reasonable one or even the reading the court would have reached if the question initially had arisen in a judicial proceeding."[18]

In particular, the Board's ruling in the present case warrants deference for a number of reasons. First, the Board is "the type of agency to which deference should presumptively be afforded" because of *the scope of its authority.* Congress has vested the Board with "primary and substantial responsibility for administering" federal regulation of the national banking system.[19] The Board exercises "general supervisory" powers over member banks,[20] and is responsible to bring enforcement actions to prevent member banks from engaging in "unsafe or unsound" banking practices.[21] The Board thus formulates national banking policy, and, in implementing this policy, exercises broad rulemaking and adjudicative powers.

Second, deference to the Board's conclusions is warranted by its *expert knowledge of commercial banking.* "Not only because Congress has committed the [Federal Reserve] [S]ystem's operation to [the Board's] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all of its phases, . . . their judgment should be conclusive upon any

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18 *Fed. Election Comm'n v. Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 39, 102 S.Ct. 38, 46, 70 L.Ed.2d 23 (1981) (emphasis added) (citations omitted).

19 *Compare Democratic Senatorial Campaign Comm.*, 454 U.S. at 39, 102 S.Ct. at 46.

20 *See* 12 U.S.C. § 248 (1976).

21 *See* 12 U.S.C. § 1818(b) (Supp. IV 1980). *See also* 12 U.S.C. § 501a (1976) (enforcement actions for violation of banking laws and regulations).

matter which . . . is open to reasonable difference of opinion. Their specialized experience gives them an advantage judges cannot possibly have . . . in ascertaining the meaning Congress had in mind in prescribing the standards by which they should administer [the system]."[22]

Third, deference to an agency's construction of the statute is called for because *the agency's decision applies general, undefined statutory terms*—"notes and securities"—to particular facts. While the Glass-Steagall Act contains a sweeping prohibition of commercial banks' trading in "securities," that term is, of course, not self-defining.[23] Moreover, we cannot assume that Congress intended the term to comprise a set of rigid and unchanging categories. Rather, such statutory drafting "leave[s] the agency with the task of evolving definitions on a case-by-case basis."[24] The regulatory structure of the banking laws must be permitted to adapt to the changing financial needs of our economy.[25] Congress has delegated to the Federal Reserve Board, rather than to this court, the complex task of applying the Act's general proscriptions to current business reality. We must therefore defer to the Board's interpretation of the statute if that interpretation is reasonable.

22 *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 450, 67 S.Ct. 411, 415, 91 L.Ed. 408 (1947) (Rutledge, J. concurring). *See Board of Governors of Federal Reserve System* v. *Investment Co. Inst.*, 450 U.S. 46, 56 n.21, 101 S.Ct. 973, 981 n.21, 67 L.Ed.2d 36 (1981) (citing *Agnew*) [hereinafter cited as *ICI II*].

23 *See infra* p. 143 [13a-16a].

24 *Puerto Rico* v. *Blumenthal*, 642 F.2d 622, 635 (D.C. Cir. 1980), *cert. denied*, 451 U.S. 983, 101 S.Ct. 2315, 68 L.Ed.2d 840 (1981); *Chisholm* v. *FCC*, 538 F.2d 349, 358 (D.C. Cir.), *cert. denied*, 429 U.S. 890, 97 S.Ct. 247, 50 L.Ed.2d 173 (1976).

25 *Cf. M & M Leasing Corp.* v. *Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), *cert. denied*, 436 U.S. 956, 98 S.Ct. 3069, 57 L.Ed.2d 1121 (1978) (bank laws construed to permit "use of new ways of conducting the very old business of banking"). The current situation of the commercial paper market could not have been foreseen by Congress at the time the Glass-Steagall Act was passed: that market has changed drastically since the Depression. *See infra* note 85.

Finally, "*the thoroughness evident in the consideration* [of an agency's interpretation of a statute], *the validity of its reasoning*, [and] *its consistency with earlier and later pronouncements*" are factors that bear upon the amount of deference to be given to an agency's ruling.[26] In this instance, the agency's interpretation of the statute is based on a thorough and expert review of the relevant legal and policy considerations as well as of the facts of this case. The Board conducted an extensive inquiry into the operation of Bankers Trust commercial paper operations and the function of the commercial paper market; it clearly set forth its findings, conclusions, and bases for its reasoning.[27] And the Board's conclusion is consistent with prior decisions, including some roughly contemporaneous with the passage of the Glass-Steagall Act.[28]

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26 *Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 164, 89 L.Ed. 124 (1944) (emphasis added). *See Democratic Senatorial Campaign Comm.*, 454 U.S. at 39, 102 S.Ct. at 46 (citing *Swift*); *Adamo Wrecking Co. v. United States*, 434 U.S. 275, 287 n.5, 98 S.Ct. 566, 574 n.5, 54 L.Ed.2d 538 (1978) (same).

27 Federal Reserve Statement, *supra* note 3.

28 For example, in 1933 the Board stated that commercial paper, defined as short-term paper issued for obtaining funds for current transactions and purchased by banks and corporations with temporarily idle funds, should not be considered an investment security. *See Federal Securities Act: Hearing on H.R. 4314 before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 180-81 (1933); *Securities Act: Hearings on S. 875 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 120 (1933); Federal Reserve Statement, *supra* note 3, at 11, J.A. at 230.

The assumption that commercial paper is a loan rather than a security pervades current banking regulation. The Board has ruled that issuance of commercial paper by a bank holding company does not fall within section 20 of the Glass-Steagall Act, the analogous provision for those companies. *See* 12 C.F.R. § 250.221(e)(1982). Under the rules of the Comptroller General's office, commercial paper holdings by banks are subject to the statutory limits on loans rather than investment securities. *See* 12 C.F.R. § 7.1180 (1982) (interpreting 12 U.S.C. § 84 (1976)); Federal Reserve Statement, *supra* note 3, at 11-12, J.A. at

For these reasons, which we have considered in prior opinions and which may frequently be found of use in evaluating administrative agency decisions, we should hesitate to overturn the Board's decision as long as that decision is a reasonable interpretation of the Glass-Steagall Act. And, as will appear below, the decision was reasonable. We do not, however, rest merely on the deference to the conclusions of the Federal Reserve Board. "[T]o accord deference is not to abdicate our duty to construe the statute, for 'the courts are the final authorities and are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute.' "[29] We therefore turn to an analysis of the application of the Glass-Steagall Act to the present case.

III. APPLICATION OF THE GLASS-STEAGALL ACT

Taking account of appropriate deference to the Board's expertise and administrative responsibility, we find that its ruling and the reasoning which supports it are essentially correct. An inquiry into the language and legislative history of the statute, and the policies underlying it, supports the Board's conclusion that the commercial paper marketed by Bankers Trust is not a "security" within the Glass-Steagall Act.

A. *Background*

Congress passed the Glass-Steagall Act in 1933, in response to what it perceived to be the abuses which resulted from the involvement of commercial banks in securities underwriting. Congress considered that commercial banks, by underwriting

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230-31. And commercial paper is treated as a loan for bank call reports and bank examination by the Federal Reserve Board. *Id.*

29 *Nat'l Ass'n of Recycling Inds., Inc. v. ICC*, 660 F.2d 795, 799 (D.C.Cir. 1981) (citations omitted).

stocks, had fueled the rampant speculation that preceded the Great Depression. Congress' principal concern in amending the banking laws, however, was to protect the solvency and integrity of the banks themselves.[30]

Stock underwriting by commercial banks undermined bank solvency in a number of ways. Most directly, commercial banks that engaged in underwriting tied up depositors' funds in the purchase of unsound or speculative securities. These investments placed commercial deposits at risk.[31] The promotional pressures exerted by underwriting activities also threatened bank solvency. To augment their commissions from securities sales, commercial banks used their credit facilities to lend to purchasers of securities.[32] Banks were also tempted to make unsound loans to client-issuers, because these loans might improve the balance sheet of these enterprises and thereby make their securities more marketable. When speculative ventures failed, these loans to purchasers and issuers were often not repaid, undermining bank solvency and depositor confidence in the banks.[33]

In addition to inducing commercial banks to purchase unsound securities and to make unsound loans, banks' participation in the securities market had more indirect effects on bank solvency. Banks' association with speculative securities ventures undermine the confidence of bank depositors in the stability of the banks.[34] Moreover, banks which underwrote

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30 *Senate Comm. on Banking and Currency, Operation of the National and Federal Reserve Banking Systems*, S. Rep. No. 77, 73d Cong., 1st Sess. 2-4, 6-13 (1933).

31 *Id.* at 9-10.

32 *See* 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley); *Operation of the National and Federal Reserve Banking Systems: Hearings Pursuant to S.Res. 71 before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3d Sess. 87 (1931) (remarks of Chairman Glass) [hereinafter cited as *Hearings*].

33 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley).

34 *Id.*

stock issues could not be relied upon to give prudent and disinterested investment advice to their depositors, for they naturally had an incentive to urge depositors to purchase shares of the issues the bank was underwriting.[35] Finally, these banks would also "dump" excess issues of unmarketable securities on their own trust departments.[36]

Congress passed the Glass-Steagall Act to correct these abuses. The Act is a prophylactic measure designed to prevent commercial banks from being exposed to the dangers which inevitably followed upon their participation in investment banking. "Congress acted to keep commercial banks out of the investment banking business largely because it believed that the promotional incentives of investment banking and the investment banker's pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system."[37]

B. *Statutory language*

Congress accomplished the separation of commercial and investment banking in sections 16 and 21 of the Glass-Steagall Act. We first ask whether the language of these sections clearly evinces a congressional determination to prohibit the activities in which Bankers Trust has engaged; if so, our inquiry necessarily comes to an end.[38]

Section 16 provides that a bank "shall not underwrite any issue of *securities or stock*" and shall not "purchase . . . for its own account . . . any *shares of stock* of any corpora-

35 *Hearings*, *supra* note 32, at 237.

36 *Id.*

37 *Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 634, 91 S.Ct. 1091, 1100, 28 L.Ed.2d 367 (1971) [hereinafter cited as *ICI I*].

38 *E.g.*, *Transamerica Mortgage Advisers, Inc.* v. *Lewis*, 444 U.S. 11, 16, 100 S.Ct. 242, 245, 62 L.Ed.2d 146 (1979).

tion."[39] We can find nothing in the language of this section that explicitly articulates a congressional intent to bar commercial banks from trading in commercial paper. The terms "securities" and "stock" are not defined by the Act; section 16 in no way refers explicitly to notes, the generic financial term which Congress might have used to encompass commercial paper.[40] Indeed, banks are authorized to "discount and negotiate promissory notes, drafts, bills of exchange, and other evidences of debt. . . ."[41] It is clear, then, that section 16 does not prohibit banks from selling or underwriting *all* notes, but *only* "securities or stock"; and the section does not indicate whether the commercial paper at issue in this case is included within that statutory prohibition.

We turn then to section 21 of the Act, which forbids banks from underwriting "stocks, bonds, debentures, notes, or other securities. . . ."[42] Although this statutory provision explicitly refers to "notes," that term is susceptible of at least two interpretations. First, it may refer to a specific type of long-term debt security, one that closely resembles a bond or debenture but is of shorter maturity.[43] A note in this sense, like a bond or a debenture, is issued under an indenture agreement to raise money available for an extended period of time as part of the corporation's capital structure. An investment note

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39 12 U.S.C. § 24 Seventh (Supp. IV 1980) (emphasis added). The Act allows for several exceptions; the one pertinent here is that for "investment securities." *See infra* pp. 145-146 [19a].

40 *See infra* p. 143 [15a] & note 44.

41 12 U.S.C. § 24 Seventh (Supp. IV 1980).

42 12 U.S.C. § 378(a)(1) (1976). If the language of *either* section 16 *or* section 21 must be interpreted to prohibit Bankers Trust's marketing of commercial paper, that interpretation of course governs. *See generally ICI II*, *supra*, note 22, 450 U.S. at 62-65, 101 S.Ct. at 984-86.

43 *See, e.g.*, 1 A. Dewing, The Financial Policy of Corporations 180 (4th ed. 1941); G. Munn, Encyclopedia of Banking and Finance 132 (7th ed. 1973).

differs from these other instruments in that it matures more quickly—in a few, rather than twenty or more, years.

Second, the term "notes" is sometimes used generically to refer to *any* promissory instrument regardless of maturity or negotiability.[44] In this sense, commercial paper may also be referred to as a promissory "note." Such a note differs sharply from an investment "note": commercial paper is used to obtain short-term credit for current transactions, rather than capital funds for long-term projects. Its maturity generally ranges from one to two months, and rarely exceeds nine months.[45]

The language of section 21 suggests that Congress intended only to prohibit the marketing of investment notes—*i.e.*, that it intended to use "notes" in its more specific meaning. Each of the terms listed by Congress—"stocks," "bonds," "debentures" and "notes"—refers to a specific type of long-term investment security.[46] In contrast, "notes" in the more general sense would also include financial instruments, such as commercial paper, which have little in common with these long-term investment securities.[47] Moreover, "notes" used in its

44 *See, e.g.*, G. Munn, *supra*, note 37, at 698 (defining "note" as a "written promise . . . to pay a certain sum of money to the . . . payee").

45 *See also infra* p. 149 [26a] & note 80.

46 "Stocks," of course, represent ownership interests in a corporation. "Bonds" are secured debt instruments, issued under a trust indenture agreement, that bear long-term maturities and are offered to the public in small denominations. "Debentures" differ from bonds only in that they are unsecured.

47 *See Third Nat'l Bank in Nashville v. IMPAC, Ltd.*, 432 U.S. 312, 322 & n. 16, 97 S.Ct. 2307, 2313 & n. 16, 53 L.Ed.2d 368 (1977) ("words grouped in a list should be given related meanings"); *Am. Maritime Ass'n v. Stans*, 485 F.2d 765, 768 (D.C.Cir. 1973) (same). *Cf. Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307, 81 S.Ct. 1579, 1582, 6 L.Ed.2d 859 (1961) (statutory term "gathers meaning from the words around it").

Similarly, under the familiar principle that where general words follow specific words in an enumeration, the general words are

more general sense would include debt instruments such as bonds and debentures; the explicit statutory reference to the latter would then be redundant.[48] For these reasons, specific inclusion of the terms "stocks," "bonds," and "debentures" suggests that the narrower meaning of the term "notes" was intended. We conclude that the context in which the term "notes" is used strongly implies Congress' intent not to include commercial paper within the sweep of the Act's prohibition.

Both section 16 and section 21 thus demarcate a fundamental division between notes which represent commercial banking

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construed to embrace only items similar to those specifically enumerated, *see, e.g., Harrison v. PPG Inds., Inc.*, 446 U.S. 578, 588, 100 S.Ct. 1889, 1895, 64 L.Ed.2d 525 (1980), the phrase "or other securities would include *only* financial instruments with the economic characteristics of those listed, *see supra* note 46, *not* commercial paper.

The conclusion that commercial paper differs markedly from those instruments which Congress intended to prohibit commercial banks from underwriting depends ultimately upon an analysis of the relevant economic characteristics of these instruments, such as the characteristics noted in text. It is clear that commercial paper differs from the family of specific instruments listed in section 21 of the Act; we explain below the relevance of these differences to the policies wich Congress intended the Act to advance. *See infra* parts IIIC (legislative history) and IIIE (functional analysis of the commercial paper market).

48 *See Ass'n of Am. R.Rs. v. United States*, 603 F.2d 953, 964 (D.C. Cir. 1979) (presumption that "Congress [does] not employ superfluous language").

A third reason to reject a broad definition of the term "note" is that this definition would include a number of instruments in which banks have traditionally traded—for example, certificates of deposit, notes evidencing a mortgage and notes representing commercial loans in connection with a loan syndication. All of these clearly involve a "written promise to pay a certain sum to the payee," *see supra* note 44; their sale by banks would therefore be prohibited by appellees' reading of the statute. Moreover, it makes little sense to argue, as do appellees, that we may escape this quandary by interpreting the Glass-Steagall Act to prohibit only banking practices not otherwise authorized by the banking laws: The banks may only exercise expressly granted powers in any event. *See, e.g., Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972); *Saxon v. Georgia Ass'n of Indep. Ins. Agents, Inc.*, 399 F.2d 1010 (5th Cir. 1968).

transactions—transactions which are, of course, permitted under the Act—and securities, such as investment notes, which commercial banks are prohibited from underwriting. Section 16 indicates this distinction by authorizing commercial banks to negotiate "promissory notes," while forbidding banks to negotiate "securities or stocks." Section 21 makes the distinction by barring banks from trading in specified instruments for raising capital as part of the permanent financial structure of a corporation—stocks, bonds, debentures and notes—while implicitly permitting transactions in other types of debt instruments. And the language of these sections, while not conclusive, strongly suggests that sale of commercial paper should be treated as a "loan" rather than a sale of securities for the purposes of the Act.

C. *Legislative history*

The distinction between commercial loans and securities emerges as well from an analysis of the legislative history. Throughout its debates on the causes of the imperiled state of the banking industry, Congress nowhere considered the banks' activity in the commercial paper market as contributing to their difficulties.[49] The commercial paper market was simply not part of the problem to which the Glass-Steagall Act was addressed.[50] Rather, Congress focused its attention on the commercial banks' participation in "speculative" securities markets: their extensive underwriting of long-term holdings of high risk stocks and bonds.

For example, the Senate Report on the Act notes that "[t]he outstanding development in the commercial banking system during the prepanic period was the appearance of excessive

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49 *See* Federal Reserve Statement, *supra* note 3, at 14-15, J.A. at 233-34.

50 This is particularly remarkable because, at the time the Glass-Steagall Act was passed, almost all commercial paper issued was purchased by commercial banks for their own account. *See* Hurley, *supra* note 5.

security loans, and of over-investment in securities. . . . [A] very fruitful cause of bank failures . . . has been the fact that the funds of various institutions have been so extensively '*tied up' in long-term investments*."[51] Congress condemned "the excessive use of bank credit in making loans for the purpose of *stock speculation*. . . ."[52] In short, the purpose of the Act was to reverse "a loose banking policy which had turned from the making of loans on *commercial paper* to the making of loans on *security*."[53]

The distinction between bank participation in the securities and in the commercial paper markets is also illustrated in Congress' treatment of section 2(b) of the McFadden Act.[54] Section 2(b) limited the amounts of "investment securities" national banks could hold.[55] It is clear, however, that *commercial paper was not considered an "investment security"* under the McFadden Act: banks were left free to trade in commercial

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51 S. Rep. No. 77, *supra* note 30, at 8 (emphasis added).

52 *Id.* at 9 (emphasis added).

53 *Id.* at 4 (emphasis added). The hearings and floor debates of the Act are also replete with evidence that Congress was concerned with banks' speculation in long-term equity and debt securities rather than with their participation in the commercial paper market. *See, e.g.*, 77 Cong. Rec. 3725, 3837 (1933) (remarks of Sen. Glass); *Hearings, supra* note 32, at 1006-19; *Operation of the National and Federal Reserve Banking Systems; Hearings on S. 4115 Before the Senate Comm. on Banking and Currency*; 72d Cong., 1st Sess. 146 (1932) (remarks of Sen. Glass); *id.* at 66-67 (remarks of president of American Bankers Association); 75 Cong. Rec. 9904 (1932) (remarks of Sen. Walcott); *id.* at 9911-12 (remarks of Sen. Bulkley) (promotional pressures encouraging over-development of collateral-security loans and over-production of capital securities).

54 Ch. 191, 44 Stat. 1224 (1927).

55 44 Stat. at 1226 (codified at 12 U.S.C. § 24 Seventh (Supp. IV 1980)). The Act restricted bank holdings of the securities of any one obligor to twenty-five percent of the bank's holdings. *Id.* The Glass-Steagall Act further restricted the permissible amounts of these holdings. Ch. 89, sec. 16, 53 Stat. 162, 185 (1933) (later modified).

paper without restriction.[56] It is significant, therefore, that Congress preserved the provisions of the McFadden Act when it passed the Glass-Steagall Act six years later.[57] The legislative history of the Glass-Steagall Act provides no indication that Congress intended to change the McFadden Act's definition of "investment security."[58] Moreover, it is unlikely that Congress would consider commercial paper to be a "security" but *not* an "investment security."[59] Thus, Congress' incorporation of the McFadden Act into the revised banking laws, like other aspects of the legislative history, indicates an intent to continue to leave banks free to deal in commercial paper.

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56 Federal Reserve Statement, *supra* note 3, at 9, J.A. at 228; 67 Cong. Rec. 3232 (1926); H.R. Rep. No. 83, 69th Cong., 1st Sess. 3-4 (1926). Congress was legislating to control national banks' underwriting activities, which had sprung up in the early 1900s. In contrast, these banks had dominated the commercial paper market since the middle 19th century. *See* Federal Reserve Statement, *supra* note 3, at 10, J.A. at 229; A. Greef, The Commercial Paper House in the United States at 6-7, 15-18, 403-05 (1938).

57 Ch. 89, sec. 16, 53 Stat. 162, 185 (1933).

58 *See* S. Rep. No. 77, *supra* note 30, at 16 (banks permitted to purchase and sell investment securities "to the same extent as heretofore").

59 The conclusion that commercial paper is not a "security" or "stock" would follow *a fortiori* from the conclusion that commercial paper is not an "investment security." If commercial paper is a security but not an investment security, banks would be entirely forbidden from purchasing, selling, or underwriting commercial paper, while permitted, subject to the regulation of the Comptroller of the Currency, to purchase or sell corporate debt instruments. This would be quite anomalous, for corporate debt instruments threaten to a far greater degree to cause the evils at which the Glass-Steagall Act is aimed. Moreover, if commercial paper were deemed to be a "note" within section 21 of the Glass-Steagall Act, it ought also to be a "marketable obligation[ ] evidencing indebtedness . . . in the form of [a] note[ ]"—*i.e.*, an "investment security"—under section 16. That the legislative history and administrative implementation of the McFadden Act indicate clearly that commercial paper is not an "investment security" implies therefore that it should not be considered a "note" for the purposes of the Glass-Steagall Act.

D. *The Analogy to the Securities Laws*

Plaintiffs suggest that we may infer Congress' intent from its use of the term "security" in two contemporaneous statutes—the Securities Act of 1933 and the Securities Exchange Act of 1934. Both acts define "security" to include "any note."[60] There is no reason, however, to assume that Congress intended that term to bear the same meaning in these different statutory contexts. Congress enacted the Glass-Steagall Act primarily to protect *bank depositors*.[61] By contrast, "[t]he primary purpose of the [Securities Acts] of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and *the need for regulation to prevent fraud and to protect the interest of investors*."[62]

Therefore, although Congress used the term "securities" in both the Glass-Steagall and the Securities Acts, different interpretations of "securities" may follow upon the differing regulatory purposes behind the Acts.[63] "Because securities transactions are economic in character Congress intended the application of [the Securities Acts] to turn on the *economic realities underlying a transaction*. . . ."[64] Similarly, the Court has defined the term "securities" in the Glass-Steagall Act by

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60 15 U.S.C. § 77b(1)(1976) (Securities Act); *id.* § 78c(a)(10) (Securities Exchange Act).

61 *ICI II*, *supra* note 22, 450 U.S. at 61 & n. 27, 101 S.Ct. at 984 & n. 27. *See generally supra* pp. 141-143 [11a-13a].

62 *United Housing Found., Inc.* v. *Forman*, 421 U.S. 837, 849, 95 S.Ct. 2051, 2059, 44 L.Ed.2d 621 (1975) (emphasis added).

63 The Supreme Court's recent interpretations of these provisions of the Glass-Steagall Act make no reference at all to the securities laws. *See generally ICI I*, *supra* note 37; *ICI II*, *supra* note 22.

64 *United Housing Found., Inc.*, 421 U.S. at 849, 95 S.Ct. at 2059 (emphasis added).

analyzing the economic policy behind the Act—to protect bank depositors from the hazards which ensue when commercial banks enter the investment banking business.[65] In short, the Glass-Steagall Act uses the term "security" to fence off investment banking activities from commercial banks; the securities laws use the term to define the capital markets whose economic functioning is to be regulated by the securities laws. Clearly, the scope of the term may differ in these differing contexts. We must assign the term "security" a different meaning in the Glass-Steagall and the Securities Acts if a different interpretation is called for by the respective policies of those Acts.[66]

The Supreme Court recently reaffirmed this approach to the Securities Acts in *Marine Bank* v. *Weaver.*[67] "The [Securities Exchange] Act was adopted to restore *investors' confidence in the financial markets.* . . . We have repeatedly held that the test [of whether an instrument is a "security"] 'is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.' "[68] Therefore, "[e]ach transaction must be analyzed and evaluated on the basis of the content of

65 *See infra* p. 148 [23a-25a] & notes 72-76.

66 Appellees emphasize that, because Congress *defined* "security" in the Securities Act to include "any note," it must have intended "security" in the Glass-Steagall Act to mean the same thing. But all the example of the Securities Acts shows, of course, is that Congress is capable of using "securities" to include "all notes" when it clearly defines the term in that way. Indeed, the example of those Acts suggests that, if Congress had intended so sweeping a definition of "security" in the Glass-Steagall Act, it would have enunciated such a definition in the Act. *Cf. American Tobacco Co.* v. *Patterson*, U.S. at n. 6, 102 S.Ct. 1534 at 1539 n. 6, 71 L.Ed.2d 748 ("fundamental distinction" should not be imported into a statute unless Congressional intent is clearly expressed); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 572, 99 S.Ct. 2479, 2487, 61 L.Ed.2d 82 (1979) ("when Congress wished to provide [remedy], it knew how to do so and did so expressly").

67 ____ U.S.____, 102 S.Ct. 1220, 71 L.Ed.2d 409 (1982).

68 *Id.* at ____, 102 S.Ct. at 1222 (emphasis added) (citations omitted).

the instruments in question, the purposes intended to be served, and the factual setting as a whole."[69]

In deciding that a certificate of deposit was not a security, *Marine Bank* noted two facets of the economics of these certificates: first, holders receive a fixed rate of interest rather than dividends based on profits; second, "[i]t is unnecessary to subject issuers of bank certificates of deposit to liability under . . . the federal securities laws since the holders of bank certificates of deposit are abundantly protected under federal banking laws."[70] In short, the Court focused on the potential economic gains and losses of the *investors*, who are the intended beneficiaries of federal securities regulation, in deciding whether the purposes of that regulation would be furthered by its application to the instrument in question. A different focus of analysis is called for under the Glass-Steagall Act, which aims at protecting the integrity of *banks* and the financial resources of *depositors* rather than *investors*.

We conclude that the meaning of the term "securities" under the securities laws is of little immediate relevance to the problem before us; rather, the example of these laws suggests the need for a careful economic analysis of the commercial paper market itself.

E. *Functional Analysis of Commercial Paper*

The language and the legislative history of the Glass-Steagall Act strongly suggest that commercial paper should be viewed as a loan rather than as a "security" for the purposes of the Act. However, as we have seen, neither the language nor direct evidence from the legislative history is decisive of the question before us. There is no foolproof formula by which we can decide whether the commercial paper marketed by Bankers Trust constitutes a "security." Rather, as the Board observed,

> a broad generic or literal reading of the term "security" would likely encompass a number of instruments that

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69 *Id.* at ____, n. 11, 102 S.Ct. at 1225, n. 11.

70 *Id.* at ____, 102 S.Ct. at 1225.

> banks routinely deal with in the course of their business and would, consequently, be contrary to the basic purpose of the Act. On the other hand, a highly technical or formalistic approach might permit evasions of the mandate of Congress.[71]

Because neither the literal language of the statute nor other expressions of congressional intent available to us directly indicate whether commercial paper is a "security," it is necessary to conduct a "functional analysis" of Bankers Trust's commercial paper to resolve this question. The problem becomes whether classifying commercial paper as a "security" would further the policies of the Act. As the Board phrased this inquiry:

> [I]f a particular kind of financial instrument evidences a transaction that is more functionally similar to a traditional commercial banking operation than to an investment transaction, then fidelity to the purposes of the Act would dictate that the instrument should not be viewed as a security.[72]

In adopting this functional analysis, the Board followed the Supreme Court's reasoning in its recent cases construing the Glass-Steagall Act. In *Investment Company Institute* v. *Camp* (*ICI I*) the Court noted that

> Congress was concerned that commercial banks in general and member banks of the Federal Reserve System in particular had both aggravated and been damaged by stock market decline partly because of their direct and indirect involvement in the trading and ownership of speculative securities. The Glass-Steagall Act reflected a determination that policies . . . which might otherwise support the entry of commercial banks into the investment banking business were outweighed by the "hazards"

71 Federal Reserve Statement, *supra* note 3, at 19, J.A. at 237.

72 *Id.*

and "financial dangers" that arise when commercial banks engage in the activities proscribed by the Act.[73]

Thus, if confronted with a banking practice which involves the sale of securities and for that reason threatens the "hazards" at which the Act is aimed, neither the Federal Reserve Board nor this court is free to "balance" these hazards against the perceived benefits of the proposed practice. If the practice does *not* threaten to cause these hazards, however, we need undertake no such balancing. Rather, we effectuate the will of Congress by concluding that the proposed banking practice is not within the scope of the statutory proscription.

For example, in *ICI I* the Court found that the bank's sale of participations in a bank-sponsored mutual fund posed the dangers that the Glass-Steagall Act was designed to prevent; the Court concluded that these participations were securities within the meaning of the Act.[74] Once these participations were found under this functional analysis to be "securities," the "literal language" of the Act prohibited sale by the bank.[75]

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73 *ICI I, supra* note 37, 401 U.S. at 629-30, 91 S.Ct. at 1098.

74 *Id.* at 635-38, 91 S.Ct. at 1101-02.

75 *Id.* at 639, 91 S.Ct. at 1103. *See also ICI II, supra* note 22, 450 U.S. at 65-66, 1-1 S.Ct. at 986 (analyzing *ICI I*) ("This Court's . . . determination [that the units of participation were securities] led inexorably to the conclusion that § 16 had been violated."). *ICI II* posed a different problem of statutory interpretation, as the Court itself noted. *Id.* at 66, 101 S.Ct. at 986. There, it was indisputable that the transactions under scrutiny involved "securities"; the question before the Court was whether the banks were "engaged in the business of issuing, underwriting, selling, or distributing" securities. Again, the Court embarked upon an analysis of the "hazards contemplated [by] Congress in enacting the Glass-Steagall Act" in order to conclude that the Act had not been violated. *Id.* at 66-67, 101 S.Ct. at 986-87.

Because we find that the commercial paper marketed by Bankers Trust is not a "security," we need not reach the issue, which arose in *ICI II*, of whether the bank is engaged in "underwriting" within the meaning of the Glass-Steagall Act.

The Federal Reserve Board, in resolving the present case, therefore correctly focused on whether the commercial paper marketed by Bankers Trust functioned economically as a loan or as a security. Only if commercial paper displayed the economic characteristics of a "security" would the marketing of commercial paper by Bankers Trust cause the hazards the Act was designed to prevent. The Board concluded that, in all relevant respects, the commercial paper had the economic characteristics of a loan.[76] We agree.

It is useful to review the traditional lending functions of commercial banks. The commercial lender extends *short-term* credit to businesses to finance immediate needs for working capital.[77] To assure itself of timely repayment, the commercial bank carefully evaluates the credit-worthiness of the borrower and the borrower's representations as to the use of funds. In recent years, the lender has characteristically been either a bank or a syndicate of lenders, which may include banks and lending institutions such as credit or mortgage companies.[78]

We find that the commercial paper at issue here has the economic characteristics of a traditional loan. Purchase of commercial paper, like lending by a commercial bank, represents a very reliable means by which the lender may earn a return on excess cash over a short period of time. Several features of the commercial paper market are salient in this respect.

First, the default rate on commercial paper is extremely low: only highly solvent corporations, with the best possible bond ratings, are able to market commercial paper. Indeed, the default rate on commercial paper is much lower than that on

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76 Statement, *supra* note 3, at 17-20, J.A. at 236-39.

77 *See, e.g.*, D. Hayes, Bank Lending Policies 89-91 (1977); J. Culbertson, Money and Banking 308-09 (2d ed. 1977). In considering the Glass-Steagall Act, Congress emphasized the distinction between short-term and long-term capital financing. *See supra* p. 145 [18a] & notes 52-53.

78 *See* Pollock, *Notes Issued in Syndicated Loans—A New Test to Define Securities*, 32 Bus. Lawyers 537, 538 (1977).

ordinary commercial loans made to high-grade commercial customers.[79]

Second, Bankers Trust commercial paper, like most commercial loans, is of very short maturity: it is generally redeemable at face value within 30 to 90 days.[80] Short maturity not only makes commercial paper a very liquid investment; it also reduces risk, because the financially strong corporations which can issue commercial paper are unlikely to deteriorate over the short period during which purchasers must hold the paper.

Third, because commercial paper is sold by Bankers Trust in denominations averaging one million dollars or more,[81] this paper is placed only with sophisticated purchasers—large institutions such as pension funds, money market mutual funds, insurance companies and nonfinancial corporations with large amounts of idle cash.[82] These purchasers, like commercial banks, are well able to evaluate the riskiness of the investments by verifying representations about the issuers. Three indepen-

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79 Federal Reserve Statement, *supra* note 3, at 3, J.A. at 222; Hurley, *supra* note 5, at 526-29. The Board's empirical studies found that the default rate on commercial paper is only a fraction of that on commercial loans. Companies which began to experience financial difficulties, such as Chrysler Financial Corp. and International Harvester Credit, must withdraw from the commercial paper market. Ironically, these corporations turn to commercial banks to meet their needs for current funding.

80 *See* Report from the Board's On-site Investigation of Bankers Trust 2 (8 May 1980) (average maturity of Bankers Trust notes 60 days), J.A. at 200 [hereinafter cited as Report]; Federal Reserve Statement, *supra* note 3, at 2, J.A. at 221. *See also* Hurley, *supra* note 5, at 530; Comment, *supra* note 5, at 364. According to a Federal Reserve Board survey, the maturities of short-term commercial and industrial loans range from 36 to 105 days. 67 Fed. Res. Bull. A26 (Dec. 1981).

81 *See* Report, *supra* note 80, at 2, J.A. at 200. The minimum denomination Bankers Trust will sell is $100,000.

82 Hurley, *supra* note 5, at 529; Comment, *supra* note 5, at 362-66.

dent rating services also conduct thorough periodic investigations of issuers' financial condition.[83]

For all these reasons, investment in commercial paper, far from resembling securities speculation, is less risky even than banks' ordinary commercial lending.[84] The key difference between the commercial paper sold by Bankers Trust and the traditional lending of commercial banks is that capital is lent by other investors rather than by the bank.[85] In the traditional loan transaction, the commercial bank *purchases* commercial paper; in the present case, the bank acts as agent in the *sale* of commercial paper. The bank is simply on the other side of the transaction. The question which faced the Board is whether commercial paper should be considered a "security" merely because the bank acts as the seller rather than the purchaser of the commercial paper—*i.e.*, whether the role of the bank in and of itself makes the transaction one prohibited by the Glass-Steagall Act.[86]

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83 *See* sources cited at note 82 *supra*.

84 Notably, securities differ strikingly from loans in all three respects. First, purchasers of securities, unlike purchasers of commercial paper, may liquidate their holdings, if at all, only at whatever price the market is currently paying for the stock. Second, because this price will fluctuate with the fortunes of the firm and with general economic conditions, holding securities is risky (though of course the degree of risk will depend on the profitability of the enterprise and the terms of the security agreement). Third, securities are generally available in much smaller denominations than commercial paper, so that they may be traded by the public on the open market.

85 Federal Reserve Statement, *supra* note 3, at 19, J.A. at 238. When Congress passed the Glass-Steagall Act, this difference was less marked than it has been in recent years: banks not only arranged loans in private transactions, but also purchased the vast bulk of instruments sold through the commercial paper market. *See id.* at 18, J.A. at 237; Hurley, *supra* note 5, at 529. *Compare supra* p. 148 [25a] & n. 78 (in commercial bank loan, lender may be either the bank itself or a syndicate of other lenders).

86 *See Becker*, 519 F. Supp. at 615-16.

We agree with the Board that Bankers Trust may sell as well as purchase commercial paper. The bank's role as seller does not threaten the bank with those dangers which the Glass-Steagall Act was designed to prevent. Because commercial paper is like a loan rather than a security, marketing of commercial paper by the bank does not have the same economic impact on the bank as would marketing of securities.

This is confirmed by an analysis of the dangers which the Glass-Steagall Act was designed to prevent.[87] One such danger was that bank underwriting of *securities* may "tie up" depositors' funds in speculative securities. Bankers Trust's sale of commercial paper does not create this danger because of the features of commercial paper already noted. First, the bank acts simply as an agent in the sale of commercial paper; it does not agree to purchase the paper on its own account—*i.e.*, with the funds of depositors.[88] Second, commercial paper is of prime quality, sold only by corporations with well-established credit ratings: commercial paper is not a "speculative" holding.[89] Third, commercial paper is held by the lender only for 30 to 90 days:[90] the lender may readily convert his holdings to cash and does not bear the risk of long-term fluctuations in the value of the enterprise.

The other set of dangers addressed by the Glass-Steagall Act comprises the conflicts of interest that arise when a commercial bank underwrites securities.[91] Again, Bankers Trust does not face these conflicts.

First, the bank cannot use its credit facilities in order to facilitate sale of its commercial paper. Because the interest on a commercial loan is higher than that paid out on commercial

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87 *See supra* pp. 141-43 [11a-13a].

88 Report, *supra* note 80, at 4, J.A. at 202; Federal Reserve Statement, *supra* note 3, at 2.

89 *See supra* pp. 148-149 [25a-27a].

90 *See supra* p. 149 [26a-27a].

91 *See supra* pp. 142-143 [12a-13a].

paper, a purchaser of commercial paper would not use a commercial loan to finance its purchases.[92] Conversely, the bank is under no incentive to advance unsound loans to shore up its issuers of commercial paper, because these issuers must be, by the nature of the commercial paper market, financially sound.[93]

Second, Bankers Trust is not in a position to abuse its reputation for prudence, or give unreliable financial advice to its depositors, in order to promote the sale of commercial paper. Commercial paper is purchased only by large sophisticated buyers who are capable themselves of evaluating the wisdom of their investment.[94] Moreover, commercial paper is very low-risk, and is issued only by very solvent corporations about whose financial prospects information is widely available.[95] It is inconceivable that a commercial bank such as Bankers Trust could, under these conditions, seek improperly to influence potential purchasers of commercial paper.[96]

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92 *See* Guidelines, *supra* note 13, at 29334. *See also* Report, *supra* note 80, at 4, J.A. at 202 (no evidence that funds borrowed from Bankers Trust are used to purchase its commercial paper).

93 *See supra* pp. 148-149 [25a-27a].

94 *See supra* p. 149 [26a-27a].

95 *See supra* p. 148 [25a-26a].

96 Finally, Bankers Trust may not "dump" its commercial paper through its trust department, for the Federal Reserve Guidelines prohibit bank sales of commercial paper to fiduciary accounts to which the bank gives investment advice. *See* Guidelines, *supra* note 13, at 29335 (Guideline #7). Insofar as the conflict of interest presented here may be entirely eliminated by an authorized regulation of the Board, it can hardly be said to pose one of the "subtle hazards" against which the Act is directed. *ICI I*, *supra* note 37, 401 U.S. at 630, 91 S.Ct. at 1098. *See also ICI II*, *supra* note 22, 450 U.S. at 66-67, 101 S.Ct. at 986 (relying on Board guidelines in finding no "underwriting" by banks); *cf. Marine Bank*, ___ U.S. at ___, 102 S.Ct. at 1225 (regulation of certificates of deposit by securities laws unnecessary because of extensive federal banking regulation).

Finally, the bank's reputation for prudence will not suffer by its association with the issue of commercial paper. Commercial paper is a highly sound short-term investment. And even if a commercial paper issuer were to default, the sophisticated purchasers of commercial paper will understand that this paper is not backed by the guarantees on commercial bank deposits.

The Board's "functional analysis" leads inexorably to the conclusion that Bankers Trust's commercial paper is not a "security" within the meaning of the Glass-Steagall Act. Transactions in commercial paper display the key economic characteristics of a commercial bank loan; and, because of these characteristics, Bankers Trust's dealings in commercial paper pose none of the hazards the Glass-Steagall Act was designed to prevent.

IV. CONCLUSION

We thus agree with the Board that Bankers Trust may continue to deal in commercial paper without violating the Glass-Steagall Act. The commercial paper it markets is not a "security" within the prohibitions of the Act. Moreover, our reasoning applies to other commercial paper which falls within the Board's guidelines—*i.e.*, prime quality commercial paper, of maturity less than nine months, sold in denominations of over $100,000 to financially sophisticated customers rather than to the general public.[97] Commercial banks which deal in this paper are not subject to the risks which the Glass-Steagall Act was designed to prevent. We hold therefore that commer-

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97 *See* Guidelines, *supra* note 13, at 29334 (Guideline # 1). The Board's Guidelines, in addition to defining permissible types of commercial paper and permissible purchasers and sellers, require forms of disclosure, record-keeping, and credit analysis by commercial banks. *See supra* p. 8. These requirements are directed against the danger that sale of third-party commercial paper might involve "unsafe or unsound [banking] practices." In finding that the transactions regulated by the Guidelines do not involve a sale of *securities*, we do not rely on these additional requirements.

cial banks may sell third party commercial paper provided that they comply with the Board's guidelines.

It is appropriate to note, however, the limits to this holding. It is conceivable that another type of commercial paper—*e.g.*, of smaller denominations, or issued to the general public—might be a "security" under the Glass-Steagall Act. Commercial bank involvement in the market for such commercial paper may well undermine bank solvency or create unavoidable conflicts of interest. Moreover, the present case does not require us to decide whether Bankers Trust is engaged in "underwriting." A commercial bank is permitted to underwrite commercial paper so long as commercial paper is not a "security." If other species of commercial paper prove to be a "security," however, the issue what constituted "underwriting" of commercial paper would then have to be decided.

Our opinion does not touch directly on other species of commercial paper. As the commercial paper market and banking practices continue to evolve, the Board will be called upon to determine in varying fact situations the scope of activities that Congress intended to permit banks to undertake. But these hypothetical situations are irrelevant to the problem before us. Because the Board correctly applied its functional analysis to the instant case, the judgment of the district court is *Reversed*.

ROBB, *Senior Circuit Judge*, dissenting:

I dissent. In my opinion the majority's holding contravenes the fundamental policy of the Glass-Steagall Act. That Act seeks to insulate commercial banking from the hazards inherent in investment banking by mandating a complete separation of those two functions. The majority decision violates this separation of functions by finding no difference under the Act between a lender in a commercial loan transaction and a seller in the sale of third-party commercial paper.

Although offering various justifications, the majority ultimately rests its holding on a "functional analysis" of Bankers

Trust's third-party commercial paper sales. In its functional analysis, the majority dismisses the difference between the bank's role as "purchaser" in a commercial loan transaction and its role as "seller" in a third-party commercial paper transaction as a case of the bank "simply [being] on the other side of the transaction." *Ante* at 150 [27a]. This distinction, however, is determinative under the Act. Through the Act Congress sought a complete separation of commercial banking from investment banking. *See Investment Co. Institute* v. *Camp*, 401 U.S. 617, 629, 632, 91 S.Ct. 1091, 1098, 1099, 28 L.Ed.2d 367 (1971). *See also Board of Governors of Federal Reserve System* v. *Investment Co. Institute*, 450 U.S. 46, 62, 101 S.Ct. 973, 984, 67 L.Ed.2d 36 (1981). The critical distinction between commercial banking and investment banking is the bank's role in the transaction.

When a bank lends money it is the investor. Following a thorough credit analysis of the potential borrower, the bank decides whether to approve the loan. A loan that the bank has approved and funded constitutes an asset of the bank for which the bank has placed its funds at risk. The bank's generation of income and collection of principal are dependent on the wisdom of the bank's credit decision, the adequacy of the loan provisions, and the bank's perseverance in collecting the loan.

In contrast, when a bank markets third-party commercial paper, it is the seller, not the investor. As seller, the bank has less incentive to conduct a thorough credit analysis of the commercial paper issuer because the bank, unlike an investor, does not place its funds at risk. The bank earns its fee upon closing the sale of the commercial paper. Once the sale is complete, the bank has no direct financial interest in the issuer's ability to meet its commercial paper obligations.

Ignoring the differences in the bank's roles as lender and as seller, the majority characterizes commercial loans as "short-term" transactions and then avers that selling commercial paper is no different than making a commercial loan because both transactions have short maturities. *Ante* at 143-144 [25a-27a]. This analysis fails for two reasons. First, any interpreta-

tion of the Act must focus on the bank's role in the transaction with a view to maintaining the Act's separation of banking functions. The majority's focus on maturities provides no help in determining whether the bank's role in the transaction violates the Act. Second, the basic premise of the majority's analysis is incorrect. Commercial lending is not limited to short-term loans. Longer maturity loans for the acquisition of fixed assets and for permanent increases in working capital are important commercial lending services which the majority conveniently ignores. *See* D. Hayes, *Bank Lending Policies*, 89, 107, 109 (2d ed. 1977); G. Munn, *Encyclopedia of Banking and Finance* 892 (7th ed. 1973). *See generally Business Loans of American Commercial Banks* chs. 7, 9 (B. Beckhart ed. 1959).

Similarly, an analogy between commercial paper sales and commercial loans, based on low default rates and the sophistication of the investors, *ante* at 144 [25a-27a], is not helpful. Relying on these factors, a bank could transform "transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks." *A.G. Becker, Inc.* v. *Board of Governors of the Federal Reserve System*, 519 F.Supp. 602, 615 (D.D.C. 1981).

The majority says that analysis of the hazards of mixing commercial and investment banking "confirms" the result reached through its functional analysis. I reach the opposite conclusion. In *Investment Co. Institute* v. *Camp*, 401 U.S. 617, 91 S.Ct. 1091, 28 L.Ed.2d 367 (1971), the Supreme Court lists several hazards that arise when commercial banks become peddlers of securities. First, commercial banks may suffer losses from imprudent security investments. *Id.* at 630, 91 S.Ct. at 1098. Second, "the bank's salesman's interest might impair its ability to function as an impartial source of credit." *Id.* at 631, 91 S.Ct. at 1099. Third, commercial banks may lose customer good will if their depositors suffer losses on investments made in reliance on the bank's involvement in the transaction. *Id.* Fourth, commercial banks may use their reputation for prudence to further their securities sales and subject that reputation to the risks necessarily incident to the investment banking business. *Id.* at 632, 91 S.Ct. at 1099. Finally,

the bank's promotional interests could conflict with its commercial banker obligation to render disinterested investment advice. *Id.* at 633, 91 S.Ct. at 1100.

The majority makes short work of the hazards discussed in the *Camp* decision. Those hazards, in the majority's view, are irrelevant here because commercial paper is a "prime quality", "very low-risk" investment, issued by "financially sound" issuers, and sold to "sophisticated" investors. *Ante* at 150-151 [28a-30a]. The majority's self-fulfilling analysis misses the point. "Prime quality" and "very low-risk" are characterizations that are justified only after an investment has been terminated without any investor loss. The drafters of the Act were certainly more wary of such characterizations in 1933 than the majority is today. The Act has no provision permitting bank sales of securities which are "prime quality" or "very low-risk".

To determine whether the bank's sale of third-party commercial paper involves the hazards that the Act seeks to prevent, we must take the perspective of the Act's drafters. The recent Penn Central experience provides such a perspective. *See generally* Staff of Securities & Exchange Commission, 92d Cong., 2d Sess., *Report to Special Subcomm. on Investigations of the House Comm. on Interstate and Foreign Commerce, The Financial Collapse of the Penn Central Company* (Subcomm. Print 1972) [hereinafter cited as *Penn Central Report*]. As a consequence of its bankruptcy on June 21, 1970 the Penn Central Transportation Company defaulted on $82.5 million in commercial paper. *Id.* at 1. Goldman, Sachs & Co., the nation's largest commercial paper dealer, had sold the commercial paper during the seven months preceding the bankruptcy. *Id.* at 290. The National Credit Office, a wholly-owned subsidiary of Dun & Bradstreet, Inc., had given Penn Central's commercial paper its highest rating, "prime", until June 1, 1970. *Id.* at 283. The investors, whom Goldman, Sachs & Co. described as "sophisticated" and "capable of making their own investment decisions," had purchased Penn Central commercial paper in $100,000 denominations. *Id.* at 290.

A review of the *Camp* warnings in light of the Penn Central experience presents a picture very different from that which the

majority draws. First, although Bankers Trust makes no commitment to purchase unsold commercial paper, it makes clear in its promotional letter to commercial paper issuers that such purchases are within the ambit of its investment services.

> However, in those rare occasions in which we would be unable to satisfy all of [the issuer's] requirements through the placement of paper with investors, we may, from time-to-time and without prior commitment, lend [the issuer] money at the commercial paper rate, and take back a commercial paper note.

(J.A. at 61). *See also* J.A. at 27, 50. The majority states that bank purchases of commercial paper would not present a problem because commercial paper is "prime quality, [is] sold by corporations with well-established credit ratings," and is a short-term investment. *Ante* at 150 [28a-30a]. Yet a bank's purchase of Penn Central's commercial paper which fit the majority's criteria just three weeks before it became worthless, would have been a perfect example of the hazard of "imprudent investment" that the Act seeks to prevent.

Second, the majority states that commercial paper issuers are "financially sound" companies and, therefore, have no need for commercial loans to strengthen their financial position. *Ante* at 150-151 [28a-30a]. However, as the Penn Central case demonstrates, commercial paper issuers are not exempt from financial difficulties. A bank's interests in handling the issuer's commercial paper sales and in protecting the bank's reputation for sound financial decisionmaking could "distort" its credit decisions or lead to unsound loans" to issuers for whom the bank regularly sells commercial paper. *Investment Co. Institute* v. *Camp*, 401 U.S. at 637, 91 S.Ct. at 1102.

The third hazard discussed in the *Camp* decision arises when a bank sells third-party commercial paper under any circumstances less idealistic than those which the majority envisions. Bank depositors who are financially able to purchase commercial paper in large denominations are likely to be among the bank's most important and influential clientele. Loss of their good will as a result of losses on investments which the bank

recommended and sold could be detrimental to the bank's commercial operations.

Finally, the majority makes the indisputable statement that when a bank sells "very low-risk" commercial paper of "very solvent" corporations to "large, sophisticated" investors the bank is not in a position to abuse its reputation for prudence or to give unreliable financial advice. *Ante* at 150 [28a-30a]. However, commercial paper sales that initially fit the majority's criteria may, before the investors are repaid, create hazards that the Act seeks to prevent.

Goldman, Sachs & Co. sold $5 million of the commercial paper of Penn Central, the nation's fourth largest corporation, to American Express Company, a sophisticated investor, on May 1, 1970. *Penn Central Report* at 286, 291. That sale, following several indications of major problems at Penn Central, *id.* at 279-86, and preceding the Company's collapse by just seven weeks, demonstrates the hazards present when there is a financial incentive to give unreliable advice. Had Bankers Trust been Penn Central's securities peddler, the association with Penn Central's collapse together with the resulting lawsuits which the bank would have had to defend would have severely damaged the bank's reputation for financial prudence. *See* Comment, *The Commercial Paper Market and the Securities Acts*, 39 U.Chi.L.Rev. 362, 378-79 nn. 112-13 (1972).

We must analyze the Act with the intent of its drafters as our guide. The Act was a "drastic step", *Investment Co. Institute* v. *Camp*, 401 U.S. at 629, 91 S.Ct. at 1098, taken during a bleak period in our country's banking history. Its drafters intended a complete separation of commercial banking from investment banking without regard to the likely "soundness" of the securities which a bank might sell. Senator Bulkley stated this uncompromising position at the time of the Act's passage: "If we want banking service to be strictly banking service, without the expectation of additional profits in selling something to customers, we must keep the banks out of the investment security business." *Investment Co. Institute* v. *Camp*, 401 U.S. at 634, 91 S.Ct. at 1100 (quoting 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley)). Permitting a bank

to sell third-party commercial paper presents the same hazards that "Congress determined . . . made it necessary to prohibit . . . [investment banking] activity to commercial banks." *Investment Co. Institute* v. *Camp*, 401 U.S. at 636, 91 S.Ct. at 1101. As a result, we must look closely to determine whether the Act prohibits banks from selling third-party commercial paper.

Unlike the majority, I find the Act's language helpful in determining whether commercial paper is a "note" or "security". For our purposes the Act raises two issues. The first issue is whether commercial paper is an instrument with which the Act is concerned—"stocks, bonds, debentures, notes, or other securities," 12 U.S.C. § 378(a)(1) (1976). The second issue is whether Bankers Trust is engaged in the "issuing, underwriting, selling, or distributing," *id.*, activities which the Act prohibits.

The majority characterizes the terms "stocks", "bonds", "debentures", and "notes" as "specific type[s] of long-term investment securit[ies]." *Ante* at 143-144 [15a]. The majority concludes that a broader definition of the term "notes" would be inappropriate because it would include instruments such as commercial paper "which have little in common with these long-term investment securities." *Ante* at 144 [15a]. The majority's reliance on maturities to force a narrow meaning onto the terms of the Act is misplaced. The Supreme Court has interpreted the Act's terms broadly.

> [N]othing in the phrasing of either § 16 or § 21 . . . suggests a narrow reading of the word "securities." To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt.

Investment Co. Institute v. *Camp*, 401 U.S. at 635, 91 S.Ct. at 1101. *See also Board of Governors of Federal Reserve System* v. *Investment Co. Institute*, 450 U.S. at 65, 101 S.Ct. 986. The terms "stocks", "bonds", "debentures", and "notes" have broad meanings which encompass a multitude of different instruments. The term "other securities" further indicates the

breadth of the Act's coverage; it catches any instruments which are not otherwise defined by the prior four terms. Taken as a group these five terms cover the spectrum of instruments which a corporation might seek to market. Relying "squarely on the language . . . of the Glass-Steagall Act," *Board of Governors of Federal Reserve System* v. *Investment Co Institute*, 450 U.S. at 65, 101 S.Ct. at 986. I would find that commercial paper is a type of instrument with which the Act is concerned.

Although analysis of the Act's terms and of the hazards with which the Act is concerned requires a finding that commercial paper is a "note or other security" under the Act, our inquiry is not complete. There remains the second issue of whether Bankers Trust's commercial paper sales is an activity which the Act prohibits. However, neither the Federal Reserve Board nor the District Court reached this second issue. *A.G. Becker Inc.* v. *Board of Governors of Federal Reserve System*, 519 F. Supp. 602, 616 n. 10 (D.D.C. 1981). Therefore the second issue is not before us on this appeal.

I would affirm the District Court's finding that commercial paper is a "note or other security" under the Act, and would remand this case for the further determinations suggested in this dissent.

Opinion of the District Court

UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

Civ. A. Nos. 80-2614, 80-2730

July 28, 1981

A.G. BECKER INCORPORATED,

Plaintiff,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Defendants.

SECURITIES INDUSTRY ASSOCIATION,

Plaintiff,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Defendants.

APPEARANCES:

Harvey L. Pitt, Henry A. Hubschman, Edson G. Case, Jr., Fried, Frank, Harris, Shriver & Kampleman, Washington, D.C., for Becker.

John M. Liftin, James B. Weidner, Janet R. Zimmer, Rogers & Wells, Washington, D.C., for SIA.

Richard M. Ashton, Neal L. Petersen, James V. Mattingly, Jr., Federal Reserve Board, Washington, D.C., for defendants.

JOYCE HENS GREEN, *District Judge*.

Pending before the Court in these consolidated actions are the parties' cross motions for summary judgment and the defendant's alternative motion to dismiss, with supporting memoranda. Plaintiffs are A.G. Becker, Inc. ("Becker"), a securities broker and dealer registered with the Securities and Exchange Commission, and the Securities Industry Association ("SIA"), an organization representing over five hundred securities brokers and dealers. They challenge a decision of the Board of Governors of the Federal Reserve System ("the Board"), which, with its individual members, are the defendants in this action. The dispute presents provocative questions concerning the delicately balanced regulatory system enacted by Congress to control the activities of the nation's banks in financial markets.

In the summer of 1978, Bankers Trust Company ("Bankers Trust"), a state chartered member bank of the Federal Reserve System, began offering for sale third party commercial paper, that is, commercial paper issued by corporations not related to the bank.[1] This effort included a marketing campaign aimed at

1 A succinct definition of commercial paper is offered in Comment, *The Commercial Paper Market and the Securities Acts*, 39 U.Chi. L. Rev. 362 (1972):

> Commercial paper consists of unsecured, short-term promissory notes issued by sales and personal finance companies; by manufacturing, transportation, trade, and utility companies; and by the affiliates and subsidiaries of commercial banks. The notes are payable to the bearer on a stated maturity date. Maturities range from one day to nine months, but most paper carries an original maturity between thirty and ninety days. When the paper becomes

issuers of commercial paper, whereby Bankers Trust agreed to act as a seller of commercial paper, performing services competitive with securities dealers. As part of this advertising, Bankers Trust offered to lend the issuer of commercial paper money equal to the amount of paper to be sold and, if the bank were unable to sell all of the issuer's paper, to take back notes reflecting the amount of paper unsold.

Becker and SIA expressed concern to the staff of the Board of Governors as to the legality of Bankers Trust's actions in a letter sent in November, 1978. Following this correspondence, plaintiffs, along with the General Counsel of the Securities and Exchange Commission ("SEC") and Bankers Trust, filed memoranda arguing over whether the sale by Bankers Trust of third party commercial paper violated certain provisions of the Banking Act of 1933 known as the Glass-Steagall Act. On June 28, 1979, after a meeting with representatives of Becker and SIA, the General Counsel of the Board issued a document entitled "Commercial Paper Activities of Commercial Banks: A Legal Analysis," which concluded that state member banks may, subject to certain limitations, sell third party commercial paper. The General Counsel offered, upon request by Becker or SIA, to recommend that the Board review his opinion. SIA, on July 26, 1979, and Becker, on January 31, 1980, requested that the Board review the General Counsel's opinion and that, in connection with that review, they initiate proceedings against Bankers Trust for violating the Glass-Steagall Act.[2]

> due, it is generally rolled over—that is, reissued—to the same or a different investor at the market rate at the time of maturity.

Id. at 363-64 (footnotes omitted).

2 Because it may affect the jurisdiction over this action, the parties dispute vigorously whether plaintiffs requested that the Board initiate cease and desist proceedings. Suffice it to quote from plaintiffs' precise language:

> This application is intended to . . . renew the SIA's request for formal action by the Board requiring Bankers Trust Company to cease and desist from its illegal activities. (Application of SIA for Review of State Member Bank Action, July 26, 1979 at 3; Record at

The Board took up the matter presented by the Becker and SIA petitions and, on September 26, 1980, issued a letter and a Statement Regarding Petitions to Initiate Enforcement Actions declaring that commercial paper was not a security within the meaning of the Glass-Steagall Act and that therefore Bankers Trust could legally sell third party commercial paper. The Board expressed concern at some potentially unsound practices that might have developed as a result of its ruling, and therefore commenced the drafting of guidelines governing the sale by state member banks of commercial paper.[3] Soon thereafter, the plaintiffs commenced this action seeking judicial review of the Board's conclusion that Bankers Trust was acting

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> 366) (Citations to the administrative record will be made as "R. at __").
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> . . . Applicant SIA respectfully asserts that the Board should (1) formally review this matter, (2) Order Bankers Trust to cease and desist from its third party commercial paper activity . . . *Id.* at 20, R. at 383.
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> . . . this memorandum is submitted to urge the Board . . . to advise Bankers Trust that its current commercial paper marketing activities are inappropriate as a matter of law and policy, and should cease. (Memorandum on Behalf of A. G. Becker Incorporated to the Staff of the Board of Governors of the Federal Reserve System Concerning the Commercial Paper Activities of Bankers Trust Company, January 31, 1980 at 3, R. at 154) The advance of Bankers Trust into the commercial paper market exceeds the boundary of any fair interpretation of where Congress intended the line to be drawn. We respectfully urge the Board, in conformity with the provisions of the Glass-Steagall Act, to issue a declaration to that effect. *Id.* at 47, R. at 198.

The petition submitted by Becker on January 31, 1979, was referred to in their letter exactly one year later seeking review of the General Counsel's opinion.

3 These guidelines were issued in the context of a policy statement on May 28, 1981, effective immediately, to govern the sale of third party commercial paper by state member banks. The Board indicated that it would accept comments on the guidelines through July 31, 1981, and that it will monitor the activities of banks in the commercial paper market to permit modification or supplementation of the guidelines as experience suggests may be fruitful. Plaintiffs' challenge to the Board's action does not include an attack on these guidelines.

within the parameters of the Glass-Steagall Act in offering for sale third party commercial paper.[4]

Surfacing intially in this controversy is the question whether this court, or any court, has jurisdiction to hear this dispute and grant plaintiffs their requested relief. It is beyond dispute that agency action is reviewable absent a showing that Congress specifically and clearly intended to preclude judicial oversight. The Board in this case has the burden of demonstrating that its decision to permit state member banks to sell third party commercial paper is insulated from review. *See Dunlop* v. *Bachowski*, 421 U.S. 560, 567, 95 S. Ct. 1851, 1857, 44 L. Ed. 2d 377 (1975); *Barlow* v. *Collins*, 397 U.S. 159, 166, 90 S. Ct. 832, 837, 25 L. Ed. 2d 192 (1970); *Abbott Laboratories* v. *Gardner*, 387 U.S. 136, 140 n.2, 87 S. Ct. 1507, 1511, 18 L. Ed. 2d 681 (1967). In *Independent Bankers Association of America* v. *Board of Governors of the Federal Reserve System*, 500 F.2d 812 (D.C. Cir. 1974), the Court of Appeals declared that "non-reviewability must be established by a clear showing

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4 Prior to the filing of this action challenging the substance of the Board's ruling, Becker sought relief in this Court for alleged violations by the Board of the Government in the Sunshine Act, 5 U.S.C. § 552b. On November 26, 1980, this Court issued a memorandum opinion containing a declaratory judgment that the defendants violated the Act's premeeting notice requirements but finding that in all other respects, the Board had acted lawfully. That decision, *A. G. Becker Inc.* v. *Board of Governors of the Federal Reserve System*, 502 F. Supp. 378 (D.D.C. 1980), *appeal docketed*, May 4, 1981, will be referred to as *Becker* I.

Additionally, Becker filed, concurrently with this action, a petition in the Court of Appeals for the District of Columbia Circuit, *A. G. Becker, Inc.* v. *Board of Govenors of the Federal Reserve System*, No. 80-2258 (D.C. Cir., filed Oct. 14, 1980), seeking review of the Board's determination that the sale by state member banks of third party commercial paper did not violate the Glass-Steagall Act. The actions were filed in both courts pursuant to the suggestion in the Court of Appeals that "[i]f any doubt as to the proper forum exists, careful counsel should file suit in both the court of appeals and the district court . . . ." *Investment Company Institute* v. *Board of Governors*, 551 F.2d 1270, 1280 (D.C. Cir. 1977). Becker's motion to stay its action in the Court of Appeals is pending.

of Congressional intent to preclude review." *Id.* at 814. Especially where an agency has resolved a pure question of law, which the Board did when it decided that commercial paper was not subject to the proscriptions of the Glass-Steagall Act,[5] courts have a special competence and judicial review is clearly the norm. *See Natural Resources Defense Council, Inc.* v. *Securities and Exchange Commission*, 606 F.2d 1031, 1048 (D.C. Cir. 1979).

The Board contends that the availability of judicial review is governed by the Financial Institutions Supervisory Act of 1966, as amended, which established procedures for the issuance of cease and desist orders by federal agencies with authority over the banking industry. Alternatively, it maintains that its refusal to commence enforcement proceedings against Bankers Trust is a matter committed to its discretion by law and therefore nonreviewable under the Administrative Procedure Act. The plaintiffs strenuously reject that Congess has entrusted the Board with absolute discretion over this matter, suggesting that the Board's interpretation of the Glass-Steagall Act is subject to the normal presumption favoring judicial review absent a showing by the Board of clear deprivation of the Court's jurisdiction. Neither ground for nonreviewability cited by the Board, plaintiffs contend, overcomes the doctrine that permits courts to review agency decision on questions of law.

The Board's initial authority for its argument that jurisdiction lacks is the Financial Institutions Supervisory Act of 1966, as amended, specifically 12 U.S.C. §§ 1818(h), (i). This legislation established procedures for the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the Board to regulate the nations financial houses and to enforce against

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5 Even the Board recognized that its conclusions necessitated a resolution of a legal question. *See* Letter to plaintiffs' counsel, September 28, 1980 at 3, R. at 664 (". . . the issues involved in these petitions are primarily legal in nature . . . "); Statement Regarding Petitions to Initiate Enforcement Actions, September 28, 1980, at 28, R. at 692 (". . . the Glass-Steagall Act issues resolved by the Board are essentially legal in nature . . . ").

unsafe or unsound banking practices. It provides, in pertinent part:

> (h)(2) . . . any person required by an order issued under this section to cease and desist from any of the violations or practices stated therein, may obtain a review of any order . . . by the filing in the court of appeals of the United States for the circuit in which the home office of the bank is located, or in the United States Court of Appeals for the District of Columbia Circuit . . . a written petition praying that the order of the agency be modified, terminated, or set aside . . . .
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> . . .
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> (i)(1) The appropriate Federal banking agency may in its discretion apply to the United States district court . . . within the jurisdiction of which the home office of the bank is located, for the enforcement of any effective and outstanding notice or order issued under this section, and such courts shall have jurisdiction and power to order and require compliance herewith; but except as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

Under the Board's view, its decision not to institute cease and desist proceedings and its judgment that commercial paper is not a security under the Glass-Steagall Act are insulated from judicial scrutiny by these provisions. A decision not to adjudicate whether Bankers Trust's conduct was illegal is, in the Board's opinion, analogous to decisions by the Federal Trade Commission and the General Counsel of the National Labor Relations Board exercising their "prosecutorial discretion." *See Moog Industries, Inc.* v. *Federal Trade Commission*, 355 U.S. 411, 78 S. Ct. 377, 2 L. Ed. 2d 370 (1958); *Federal Trade Commission* v. *Klesner*, 280 U.S. 19, 46 S. Ct. 102, 70 L. Ed. 404 (1929) (both holding unreviewable a decision by the Federal Trade Commission not to institute cease and desist pro-

ceedings under section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45) and *National Labor Relations Board* v. *Sears, Roebuck & Co.*, 421 U.S. 132, 138, 95 S. Ct. 1504, 1510, 44 L. Ed. 2d 29 (1975); *Vaca* v. *Sipes*, 386 U.S. 171, 182, 87 S. Ct. 903, 912, 17 L.Ed. 2d 842 (1967) (holding unreviewable a decision of the General Counsel of the Board not to issue an unfair labor practice complaint). The Board also finds shelter for this position in the language of the statute quoted above, in that an injunction directing the Board begin a proceeding to prevent Bankers Trust to sell third party commercial paper would, of necessity, "affect" the issuance of a cease and desist order and thus contravene 12 U.S.C. § 1818(i)(1).

The Board, however, ignores the procedural posture of the proceedings before it and before this Court. 12 U.S.C. § 1818(i) is a narrow statute, applying only to an "order issued under this section." Section 1818 establishes a detailed procedure to govern efforts by the Board to enforce against unsafe and unsound practices. None of these procedures were followed in this case. The Act provides for proper notice, a hearing, service of the Board's findings upon the bank under investigation, and review of the Board's decision in a court of appeals. In this action, Becker and SIA submitted materials to the General Counsel, who issued a legal opinion on the meaning of the Glass-Steagall Act as applied to Bankers Trust's conduct. The General Counsel, while soliciting materials from Bankers Trust, held no formal hearing but rather worked with his staff to reach a resolution of plaintiffs' expressed concerns. He gave the plaintiffs the oportunity to request that he seek review of his own decision by the Board of Governors. Plaintiffs then sought from the Board of Governors a review of the General Counsel's legal opinion and, in connection with that review, the institution of enforcement proceedings. The Board agreed with its General Counsel and decided not to institute an adjudication against Bankers Trust. At this stage, where the plaintiffs are challenging the legal conclusion reached by the General Counsel and adopted by the Board, § 1818 does not proscribe review.

This analysis finds support in *Groos National Bank* v. *Comptroller of the Currency*, 573 F.2d 889 (5th Cir. 1978). The appellate court held that jurisdiction did not vest in the district court to issue a declaratory judgment against the Comptroller, but explicitly found that "the Comptroller [had] set in motion cease and desist proceedings as authorized by 12 U.S.C. § 1818." *Id.* at 892. This is not an action such as *Groos* where "this regulatory process is not to be disturbed by untimely judicial intervention," *id.* at 895, because the administrative process here has reached a final conclusion that the Glass-Steagall Act is not violated when a state member bank sells commercial paper issued by unrelated corporations.

Moreover, it is a well recognized exception to statutes precluding judicial review that if an agency acts beyond the scope of its statutory authority, courts may exercise jurisdiction to overturn that administrative action. *See Manges* v. *Camp*, 474 F.2d 97 (5th Cir. 1973) (decision of Comptroller of the Currency outside of its authority is reviewable notwithstanding § 1818). *See also Leedom* v. *Kyne*, 358 U.S. 184, 79 S. Ct. 180, 3 L. Ed. 2d 210 (1958) (action within discretion of National Labor Relations Board General Counsel is reviewable if he exceeds statutory authority).

Section 1818 does, however, preclude the Court from granting plaintiffs' prayer that an injunction be issued ordering that cease and desist proceedings be commenced against Bankers Trust. *See* Becker Complaint at 11, ¶ 6; SIA Complaint at 8, ¶ 5. It is beyond the jurisdiction of this court, and probably any court, to order the Board, by injunction, writ of mandamus, or otherwise, to begin cease and desist proceedings against a bank. Such a directive would surely intrude upon the limitation set out in § 1818(i)(1), that "no court shall have jurisdiction to affect by injunction or otherwise the issuance . . . of any notice or order under this section . . . ." It is clear, therefore, that the Court's power to grant relief in this action is limited to reviewing the legal conclusion reached by the Board concerning the meaning of the Glass-Steagall Act, and to issuing whatever declaratory order may be appropriate.

As a second and independent ground for its argument that the Court lacks jurisdiction, the Board maintains that its decision that Bankers Trust is not violating the Glass-Steagall Act is wholly within its discretion and therefore unreviewable. The Administrative Procedure Act deprives courts of jurisdiction where "agency action is committed to agency discretion by law." 5 U.S.C. § 701(a)(2). The Supreme Court of the United States has interpreted this withdrawal of jurisdiction as predicated on a showing that nonreviewability must "fairly be inferred," from the regulatory framework, *Barlow* v. *Collins*, 397 U.S. 159, 166, 90 S. Ct. 832, 837, 25 L. Ed. 2d 192 (1970), and that the statutes are drawn such that "there is no law to apply." *Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 402, 410, 91 S. Ct. 814, 820, 28 L. Ed. 2d 136 (1971).

Whether a statute is drawn so broadly that there is no law to apply "turns on pragmatic considerations as to whether an agency determination is the proper subject of judicial review." *Natural Resources Defense Council* v. *Securities and Exchange Commission*, 606 F.2d 1031, 1043 (D.C. Cir. 1979). In that decision, the Court of Appeals set out the proper focus of the inquiry:

> . . . we first identify as precisely as possible the aspects of the agency's action against which the challenge is brought. We then evaluate the relevance of three particularly important factors: the need for judicial supervision to safeguard the interests of the plaintiffs; the impact of review on the effectiveness of the agency in carrying out its congressionally assigned role; and the appropriateness of the issues raised for judicial review. Finally, we inquire whether the considerations in favor of nonreviewability thus identified are sufficiently compelling to rebut the strong presumption of judicial review.

Id. at 1044 (citations omitted).

The exact agency action under attack in this case is the Board's ruling that the Glass-Steagall Act is not violated when a state member bank sells third party commercial paper. The Board attempts to characterize its decision as based on more

than a purely legal analysis, but this is just not the case. Although the Board solicited materials from Bankers Trust on its activities, it chose expressly not to rely on this factual material. In the Board's statement it concluded,

> Since, in the Board's opinion, the stronger argument is that commercial paper should not be treated as a security covered by the Glass-Steagall Act, the restrictions of the Act with regard to issuing, underwriting, selling, and dealing in securities do not apply. Thus, it is not necessary to reach the issue of whether the activities engaged in by Bankers Trust are prohibited by the Act.

R. At 688. Notwithstanding the Board's reliance on its special knowledge of the commercial paper market, once it decided not to address any factual matters underlying Bankers Trust's activity, it transformed the proceeding into a purely legal inquiry. Thus, the background of this dispute is materially different from that faced in *New York Stock Exchange* v. *Bloom*, 562 F.2d 736 (D.C.Cir. 1977), *cert. denied* 435 U.S. 942, 98 S.Ct. 1520, 55 L.Ed.2d 538 (1978), where the Court of Appeals decided to dismiss as unfit for review a petition seeking reversal of a decision of the Comptroller of the Currency that a specific automatic stock-investment plan did not violate the Glass-Steagall Act. In that case, the Court expressly noted that the Comptroller had assessed factual matters beyond a mere interpretation of the Act. But the Court was explicit as to how a pure legal question would be presented: "No doubt determining the general interest of Congress from the language and history of the Act is a matter of law. . . ." *Id.* at 741. A perusal of the Board's statements associated with its decision reveals that the Board resolved just a legal question in response to the Becker and SIA petitions. A weighing of the factors then set out in *Natural Resources Defense Council*, *supra*, leaves little doubt that the question presented is not only appropriate for review, but also demands judicial oversight in order to render a proper statutory interpretation.

Although the Board had discretion to make its legal decision, that discretion is neither absolute nor unreviewable. Rather, it represents the sort of administrative adjudication that has been held reviewable in the federal courts for "legal error, procedural defect or abuse." L. Jaffe, *Judicial Control of Administrative Action 362-63 (1965). See Nader* v. *Saxbe*, 497 F.2d 676, 679-80 n. 19 (D.C.Cir. 1974). In *Natural Resources Defense Council*, it was noted that the Administrative Procedure Act itself "command[s] an exacting judicial scrutiny" of agency determinations of "pure questions of law." 606 F.2d at 1048. *See* 5 U.S.C. §§ 706(2)(B),(C),(D). It is difficult to imagine an issue more suited to judicial review than the Board's determination; indeed, the Board's contentions on the merits of this litigation are predicated almost wholly on canons of statutory interpretation and an analysis of legislative history, which belie its claim that there is no law to apply. Moreover, the Board made no showing that review in this case would hamper its effectiveness in the future. It merely maintained that courts should not direct that a specific enforcement tool be chosen, and that the statute's lack of guidance as to when a cease and desist order is appropriate should be respected. Although it is true that § 1818 offers scant direction governing when the Board should institute cease and desist proceedings, whether the Board's legal conclusion is proper rests on inquiries familiar to all courts.

Further, the Board's suggestion that nonreviewability can fairly be inferred from the statutory framework is flawed. Defendants contend that § 1818(b)(1) suggests that courts should not interfere in actions such as this. That section provides that "[i]f in the opinion of the appropriate . . . agency, any insured bank" has violated the law or engaged in an unsafe practice, "the agency may issue" a notice of charges to initiate enforcement proceedings." This section neither expressly nor impliedly affects the review of purely legal determinations. It merely leaves the Board with discretion to decide when to initiate enforcement proceedings. The Board's characterization of its discretion sweeps too broadly, because it attempts to apply this narrowly drawn enactment to insulate

from review any ruling on a wholly legal issue as long as the decision is somehow related to the institution of enforcement actions.[6]

The parties' positions as to the exact nature of the Board's action are not entirely illuminating because, in one sense, they are all only partially accurate. The plaintiffs assert (and it would be difficult to contravene), that the Board issued a ruling on a question of law, *i.e.*, that state member banks, under the Glass-Steagall Act, could permissibly sell third party commercial paper. The Board correctly notes, though, that this decision was pronounced in the context of deciding whether to initiate cease and desist proceedings against Bankers Trust. Neither the judicial nor the administative processes provide for decisions on legal questions in a vacuum; each dispute is occasioned by factual developments that give rise to a particular problem. The difficulty courts face is in effectuating the delicate balance between the smooth exercise of administrative discretion in areas where agencies have expertise and the right of a party aggrieved with an administrative agency's interpretation of a legal question to seek judicial review.

The statutory scheme created in § 1818 precludes judicial interference in the enforcement processes until the appropriate stage, but nothing in § 1818, nor even in traditional canons of administrative law, prevents this Court from reviewing the propriety and correctness of the Board's legal determination that state member banks may sell third party commercial paper.[7] To hold that jurisdiction is absent here would be to vest

6 The parties briefed and argued the question whether the Board's decision was ripe for resolution in this Court because, at the time the motions were filed, the Board had not issued the promised guidelines to guard against what it thought to be potential unsafe practices resulting from a state member bank's sale of third party commercial paper. When these guidelines were issued, however, *see n.* 3, *supra*, this issue evaporated from this controversy and hence will not be addressed.

7 This decision by the Board will undoubtedly have far reaching effect, much broader than merely permitting Bankers Trust to continue its commercial paper activity. The Board itself, as it issued guidelines

the Board with unreviewable discretion in any proceeding, limited only to facts presented, to resolve broad legal questions that are particularly within the competence of the courts to decide. Since the Court may not intrude into the congressionally sanctioned enforcement procedures set out in § 1818, and cannot therefore enjoin the Board to institute cease and desist proceedings, the Court's authority is restricted to resolution of the legal question presented and the grant of equitable relief consonant with that decision, within the bounds of appropriate judicial review.[8]

Before proceeding to consider the substance of the Board's conclusion, the parties vociferously dispute the degree of deference to be given the Board's expertise in the regulation of commercial banking in the United States. The Board suggests that its decision is immune from judicial alteration unless arbitrary, capricious, or wholly irrational. Plaintiffs contest this claim, pointing out that they challenge the Board's ruling on a legal question, reversal of which is mandated by the Administrative Procedure Act if not in accordance with the statute. 5 U.S.C. § 706.

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for all banks to follow, recognized that many banks were likely to adopt the route of Bankers Trust.

8 Although not raised by the parties, one final point on the jurisdictional issue warrants mention. In *Becker I*, the Court found that the Board's closure of its meetings on the petitions of *Becker* and *SIA* satisfied exemption 10 of the Sunshine Act, 5 U.S.C. § 552b(c)(10), which permits an agency to refuse to open a meeting concerning a decision to participate in adjudicatory proceedings, because the possibility of cease and desist proceedings was raised and discussed. That finding does not foreclose the determination that the matter on review at this time is the legal determination reached by the Board in conjunction with its decision not to initiate an action against Bankers Trust. The part of the Board's decision which rejected any enforcement proceeding against Bankers Trust is not subject to review, and to the extent that it was likely that proceedings against Bankers Trust might be discussed at the meetings, the Court remains convinced that the meetings were properly closed. That cease and desist proceedings may have been mentioned, however, does not assault the Court's authority to review the Board's resolution of the legal question at issue herein.

Amidst these opposing contentions the Court of Appeals has recently reaffirmed the Court's delicate role in deciding cases such as these:

> We are fully aware of the deference due the construction placed on a statute by an agency charged with the responsibility for administering it. . . . However, to accord deference is not to abdicate our duty to construe the statute, for the "courts are the final authorities and 'are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute.' "

National Association of Recycling Industries, Inc. v. *Interstate Commerce Commission*, 660 F.2d 795 at 798-99 (D.C.Cir., 1981). Specifically with regard to federal banking legislation, the Supreme Court has recognized the expertise of the Board in interpreting and administering that statute. *See Board of Governors* v. *Agnew*, 329 U.S. 441, 450, 67 S.Ct. 411, 415, 91 L.Ed. 408 (1947). Nonetheless, the duty to examine the Board's rule to ensure its accordance with the law cannot be shirked. In *National Distributing Co.* v. *United States Treasury Department*, 626 F.2d 997 (D.C.Cir. 1980), the Court noted,

> This Court is vested by statute with the authority and responsibility to "decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action.". . . We are required to "hold unlawful and set aside agency action, findings, and conclusions found to be . . . not in accordance with the law[.]"

Id. at 1019, *quoting* the Administrative Procedure Act, 5 U.S.C. § 706.

Some illumination of the statutory framework surrounding this litigation is appropriate. The Glass-Steagall Act was part of a package of banking reforms passed during the early part of the Presidency of Franklin Delano Roosevelt. Two of its sections are pertinent to this dispute:

Section 16 (12 U.S.C. § 24) Corporate Powers of Associations

Seventh. . . . The Business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the *association shall not underwrite any issue of securities or stock: Provided,* That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. . . . As used in this section the term "investment securities" shall mean marketable obligations, evidencing indebtedness of any person, copartnership, association or corporation in the forms of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may be prescribed by the Comptroller of the Currency.

* * * * * * * *

Section 21 (12 U.S.C. § 378) Dealers in securities engaging in banking business; individuals or associations engaging in banking business; examinations and reports; penalties.

(a) After the expiration of one year after June 16, 1933, it shall be unlawful—

(1) For any person, firm, corporation, association, business trust, or other similar organization, ***engaged in the business of issuing, underwriting, selling or distributing***, at wholesale or retail, or through syndicate participation, ***stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits*** subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt. . . . (Emphasis added).

These provisions are made applicable to state member banks by 12 U.S.C. § 355.

The plaintiffs contend that the Board's decision contravenes the plain meaning of the Glass-Steagall Act because Bankers Trust, an institution in the business of receiving deposits, is, in their view, selling or underwriting commercial paper, which the plaintiffs argue is a security.

The first question to be addressed, then, is whether commercial paper is in fact a "note or other security" for purposes of the Glass-Steagall Act. In its statement asserting several legal bases for accepting the General Counsel's opinion, and in this litigation, the Board has attempted to justify its decision that commercial paper was not included in the Glass-Steagall Act. Section 21, the Board argues, was not intended to prohibit traditional banking functions, and the sale by Bankers Trust of third party commercial paper resembles other banking functions such as the sale of notes and bankers' acceptances to other lenders and the issuance of certificates of deposits. A decision that commercial paper is included within the Act's prohibition would, the Board suggests, jeopardize a host of traditional banking functions. Additionally, the Board analyzed the transaction involved in the sale of third party commercial paper and concluded that such activity resembled a loan, not a sale of securities. Although Congress did not, in 1933, specifically allude to commercial paper in the proceedings over Glass-Steagall, the Board points to indirect evidence that commercial paper was not intended to be included in the definition of "notes or other securities."

Plaintiffs maintain that the plain meaning of the Glass-Steagall Act prohibits exactly what Bankers Trust is doing, mixing the business of banking with the commerce of dealing in securities. The plaintiffs characterize the defendant's "parade of horribles" as irrelevant, because the traditional activities referred to by the Board are specifically permitted by other sections of the banking laws. In the plaintiffs' view what distinguishes Bankers Trust's conduct from other, more traditional banking functions, is the unique role of Bankers Trust, functioning between the issuer and the purchaser of commer-

cial paper. That role, the plaintiffs contend, is precisely what Congress intended to eliminate by its strict separation of investment banking from normal depository banking. Further, plaintiffs reject the Board's "functional anaylsis" that commercial paper is much like a loan, contending that the Board ignored the role of the bank in examining the transaction between the issuer of commercial paper and the purchaser. The plaintiffs also focus on the legislative history of the Glass-Steagall Act to support their position, citing, too, the Securities Act of 1933, which defines "securities" explicitly to include commercial paper. The Congress, plaintiffs proclaim, plainly sought to separate all dealing in speculative and other investments from the normal, more stable business of banking.

All statutory analysis begins with the recognition of an essential truth: "In any case concerning the interpretation of the statute, the 'starting point' must be the language of the statute itself, *Lewis* v. *United States*, 445 U.S. 55 [100 S.Ct. 915, 63 L.Ed.2d 198] (1980). . . ." *National Association of Recycling Industries, Inc.* v. *Interstate Commerce Commission*, 660 F.2d 795 at 799 (D.C.Cir. 1981). *See also Aaron* v. *Securities and Exchange Commission*, 446 U.S. 680, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980). Also entrenched in statutory interpretation is the principle that where a statute is not ambiguous, the party attempting to avoid its plain language must offer "persuasive reasons" for concluding that Congress did not mean what it said. *Higgins* v. *Marshall*, 584 F.2d 1035, 1037 (D.C.Cir. 1978), *cert. denied*, 441 U.S. 931, 99 S.Ct. 2051, 60 L.Ed.2d 659 (1979). *See Tennessee Valley Authority* v. *Hill*, 437 U.S. 153, 98 S.Ct. 2279, 57 L.Ed. 117 (1978). The plain meaning of a statute may be avoided where there has been a significant change of circumstances since enactment or when a literal reading leads to an unreasonable or absurd result. *Consumers Union of the United States, Inc.* v. *Heimann*, 589 F.2d 531, 534 (D.C.Cir. 1978).

What does a "plain" reading of the Glass-Steagall Act then reveal? Defendants cannot and do not seriously dispute that commercial paper is a "note or other security" as mentioned in Section 21. The parties agree that commercial paper consists of

short-term, negotiable, usually prime quality and unsecured notes. That under a strict reading of the Act, commercial paper would be covered by Section 21 is bolstered by the Court in *Investment Company Institute* v. *Camp*, 401 U.S. 617, 91 S.Ct. 1091, 28 L.Ed. 2d 367 (1971) (hereinafter *ICI I* or *Camp*) that "[t]here is nothing in the phrasing of either § 16 or § 21 that suggests the narrow reading of the word 'securities.' To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt." *Id.* at 635, 91 S.Ct. at 1101. Indeed, the statutes' unambiguous reference to "notes and *other* securities" surely indicates Congress's interpretation that the term "securities" encompassed "stocks, bonds, debentures and notes" in section 21. This meaning ascribed to section 21 applies with equal force to section 16, which does not mention "notes," but refers rather to "securities or stocks." *See Fortin* v. *Marshall*, 608 F.2d 525, 528 (1st Cir. 1979) (giving same words identical meanings in a single statute).

Does this strict interpretation of the Glass-Steagall Act lead to absurd and outrageous results? In the Board's view, many traditional commercial banking functions would simply grind to a halt were this Court to rule for plaintiffs, but their fears appear greatly exaggerated. Section 16 of the Glass-Steagall Act clearly recognizes that banks may discount and negotiate promissory notes as part of their traditional lending functions. Moreover, this Court is not presented with a broad-scale attempt by plaintiffs to reorganize the entire commercial banking industry. Rather, holding commercial paper to be included in the prohibition of the Glass-Steagall Act yields no great damage to the foundation of commercial banking. Whatever the Board decides to undertake as a result of the declaration herein is neither predicted nor directed, but when it recognizes that third-party commercial paper is a "note or other security," its mandate under the law will have been fulfilled.[9]

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9 The Board decided that commercial paper was not an investment security and then swept to the conclusion that if the Court held that commercial paper was a note or security, banks would be completely

Reliance on the literal language of sections 16 and 21 is supported by the 1971 decision in *ICI I*. In *Board of Governors of the Federal Reserve System* v. *Investment Company Institute*, 450 U.S. 46, 101 S.Ct. 973, 67 L.Ed.2d 36 (1981) (hereinafter "*ICI II*") Mr. Justice Stevens described the *Camp* decision:

> In *Camp* the Court *relied squarely on the literal language of §§ 16 and 21 of the Glass-Steagall Act*. After noting that § 16 prohibited the underwriting by a national bank of any issue of securities and the purchase for its own account of shares of stock of any corporation, and that § 21 prohibited corporations from both receiving deposits and engaging in issuing, underwriting, selling, or distributing securities, *the Court recognized that the statutory language plainly applied* to a bank's sale of redeemable and transferable "units of participation" in a common investment fund operated by the bank.

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precluded from purchasing commercial paper. This, the Board contends, is an absurd result justifying rejection of the plain statutory language. The Board's contention that commercial paper is not an investment security, however, is not persuasive.

Section 16 grants to the Comptroller of the Currency the discretion to classify some securities as investment securities to permit banks to purchase them for their own account. The Comptroller's regulations specify that an investment security is "a marketable obligation in the form of a bond, note, or debenture which is commonly regarded as an investment security" that is not "predominately speculative in nature." 12 C.F.R. § 1.3(b). The Bank points to the legislative history of the McFadden Act of 1927 where Congressman McFadden clearly states that commercial paper was not considered an investment security. *See* 67 Cong. Rec. 3232 (1926). Plaintiffs indicate, however, that the McFadden Act was eviscerated by the Glass-Steagall Act in that Congress rejected the notion that commercial banks could be engaged in the investment banking business, a premise recognized by the McFadden Act. Additionally, plaintiffs submitted a letter from the Chief National Bank Examiner, dated March 10, 1981, in a matter unrelated to this dispute, where it is held that what is a loan for one purpose may be a security for another. Becker Reply Mem., Exh. 3. Banks could, even in light of the Court's holding, continue to purchase commercial paper as they traditionally have, and plaintiffs' arguments do not appear inconsistent with the scheme of the Glass-Steagall Act.

Id., 101 S.Ct. at 986 (emphasis added). See generally Clark and Saunders, *Judicial Interpretation of Glass Steagall: The Need for Legislative Action*, 97 Banking L.J. 721 (1980) (noting that courts traditionally invoke a literal interpretation of the Glass-Steagall Act).

The broad framework of the Glass-Steagall Act demonstrates that Congress intended to pass a flat prohibition against any single type of institution—commercial or investment banking—from engaging in any of the badges incident to the others' enterprise. The statute draws broad lines, leaving no room for administrative amendment. It reflects "the unalterable and emphatic intention of Congress to divorce commercial banks from the business of underwriting and dealing in securities." *Baker, Watts & Co.* v. *Saxon*, 261 F.Supp. 247, 252 (D.D.C. 1966), *aff'd sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968). Deemed a "drastic step," the Glass-Steagall Act prohibits "commercial banks, banks that receive deposits subject to repayment, lend money, discount and negotiate promissory notes and the like, from going into the investment banking business." *ICI I*, 401 U.S. at 629, 91 S.Ct. at 1098. The Act "was a prophylactic measure directed against conditions that the experience of the 1920's showed to be great potentials for abuse." *Id.* at 639, 91 S.Ct. at 1103. The Court in *ICI I* further applied "as they were written" the Act's "literal terms" to overturn a decision of the Comptroller of the Currency to permit commercial banks to operate investment funds. *Id.*

This reading of the Glass-Steagall Act's framework is different from the Bank Holding Company Act of 1956, analyzed by the Supreme Court in *ICI II*. That statute authorizes the Board to determine whether a given activity is sufficiently related to banking to permit a nonbanking subsidiary of a bank holding company to engage therein. *See ICI II*, 450 U.S. at 73, 101 S.Ct. at 990. The Bank Holding Company Act clearly provides for the sort of discretionary decision made by the Board in this dispute, as it might be applied to a subsidiary of a bank holding company. But nowhere in the Glass-Steagall Act is the Board authorized, despite the plain language of the

statute, to permit a bank to engage in a particular activity because it does not pose risks to consumers or investors. Indeed, as the Court in *ICI I* recognized,

> From the perspective of competition, convenience, and expertise, there are arguments to be made in support of allowing commercial banks to enter the investment banking business. But Congress determined that the hazards [of that choice] made necessary to prohibit this activity to commercial banks.

ICI I, 401 U.S. at 636, 91 S.Ct. at 1101. Indeed, with the exception of the delegation in Comptroller of the Currency to determine what is an "investment security," there are no lines to be drawn.

The parties delve into the legislative history of the Glass-Steagall Act, neither producing convincing evidence of how Congress might have answered the question posed by this case were it presented in 1933. Nowhere in the record of the Act do the drafters define whether commercial paper is a note or other security. The defendants suggest that the Congress recognized that transactions in commercial paper were part of traditional banking practices at the time the Act was passed, and not part of the speculative business that gave rise to the prohibitions contained in the Act. Indeed, Senator Glass, whose name the Act bears, proposed during a debate on the Securities Act of 1933 that short term notes, including "nine months' commercial paper," be excluded from the definition of security contained in that legislation because such a definition would "radically interfere" with "ordinary commercial banking transactions." *Securities Act: Hearings on S. 875 before the Senate Committee on Banking and Currency,* 73d Cong., 1st Sess. 98 (1933). Plaintiffs counter that although banks were traditionally large purchasers of commercial paper, their role as seller was limited to occasional transactions; indeed, Congress's rejection of Senator Glass's proposal demonstrates a view that commercial paper was considered a security. It is unnecessary to trace the historical development of the commercial paper market; rather, based on the undisputed facts, the

role of Bankers Trust in its commercial paper transactions is an uncommon one for traditional banking institutions. Congress's silence as to commercial paper specifically, combined with the general scheme of the Act, indicates that it did not contemplate adjustments in the definition of "notes or other securities" by the Board or any other agency in an administrative proceeding.

The parties energetically dispute whether the definition of security in the Securities Act of 1933, which includes "any note," 15 U.S.C. § 77b(1), affects the interpretation of the Glass-Steagall Act. Although short term notes such as commercial paper are exempt from the registration provisions of the Securities Act of 1933, the antifraud proscriptions still apply. *See* 15 U.S.C. §§ 77c(a)(3), 77l(2). Defendants contend that the statutes have such different general purposes that it would be unreasonable to impute the definition of security offered in one statute to another act. *United Shoe Workers of America* v. *Bedell*, 506 F.2d 174, 188 (D.C.Cir.1974). Although the Securities Act of 1933 and the Glass-Steagall Act take regulatory aim at different financial institutions and markets, they were passed within three weeks of each other and designed to remedy the then existing catastrophe in the nation's financial markets. This is surely compelling evidence that the two statutes should be interpreted similarly. The district court, eventually affirmed in *ICI I* declared, "It would be inconsistent to conclude that Congress did not intend to obtain the equivalent meaning for the term 'securities' as used in the Securities Act of 1933 when it used the same term in the Glass-Steagall Act which was enacted by the same Congress." *Investment Company Institute* v. *Camp*, 274 F.Supp. 624, 642-43 (D.D.C.1967) (footnote omitted), *rev'd* 420 F.2d 83 (D.C.Cir. 1969), *rev'd* 401 U.S. 617, 91 S.Ct. 1091, 28 L.Ed.2d 367 (1971).

In an analogous decision, *United States* v. *American Building Maintenance Industries*, 422 U.S. 271, 95 S.Ct. 2150, 45 L.Ed.2d 177 (1975), the Supreme Court considered the phrase "in commerce" as it is used in the Federal Trade Commission Act and in the Clayton Act, and concluded that "since both sections were enacted by the 63d Congress, and both were

designed to deal with closely related aspects of the same problem—the protection of free and fair competition in the Nation's marketplaces," the statutes should be given similar interpretations. *Id.* at 277, 95 S.Ct. at 2155. Both the Glass-Steagall Act and the Securities Act were directed at curing the perceived rampant speculation by banks, securities dealers, and individuals prior to the Crash of 1929, such activity considered the chief cause of the Great Depression; their common goals suggest the relevance of the similar definitions.

The Board's final justification for its interpretation of the Glass-Steagall Act is its "functional analysis" of a commercial paper transaction which, in its view, compels the conclusion that commercial paper is more like a loan transaction than a security sale. The Board found that commercial paper, as short-term notes, functioned to provide corporations with cash and that banks, as traditional purchasers of commercial paper, effectively loaned such money to the issuers. *See* R. 682-84. The problem with the Board's analysis emerges instantaneously: it ignores the specific conduct of the bank, glossing over whether the bank purchases commercial paper for its own account, *e.g.*, its trust department, or purchases for future sale to an outside party or arranges a transaction between purchaser and seller. The Board's analysis would also sweep into its coverage almost all devices used by businesses to raise capital—including stocks and bonds—transforming transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks. The dispute over the Board's determination that commercial paper represents a loan reveals the problematic query presented in this challenge: when is a device to raise funds for a business a loan and when is it a security? One factor present in this matter compels the conclusion that the commercial paper at issue here is not a loan, and that crucial aspect is the role of Bankers Trust in the transactions.[10]

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10 The Court, like the Board, does not reach the question whether Bankers Trust was actually underwriting securities in violation of the Glass-Steagall Act. The question presented herein is whether the Board

This dispute is only the proverbial tip of the iceberg as to debates currently raging in the houses of Congress concerning the proper functions of commercial banks, especially in light of a more active "banking" role taken by securities' dealers. In its *amicus* memoranda, the Securities and Exchange Commission argues forcefully and persuasively that any alteration of the lines drawn by current banking statutes is for the popularly-elected Congress to undertake. Especially in light of these current efforts to reallocate the roles of depository and non-depository institutions, both the Court and the Board should refrain from unique and heretofore unprecedented interpretations of the 1933 Glass-Steagall Act which cast such a long shadow as does the Board's ruling on the Becker and SIA petitions. The realignment of our nation's financial industries is for the elected representatives of our nation to bring to fruition by comprehensive legislation, and not for fiat by judicial decree or by administrative policymaking.[11]

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erred when it concluded that commercial paper was not a security under the Act. Although the Court has offered various characterizations to Bankers Trust's conduct, by no means does this opinion mean to convey that the bank was underwriting securities.

11 Becker contends that it was denied procedural due process by the Board in that the Board denied its request for a hearing or oral argument and refused to provide advance notice to Becker of the Board's meetings. The Court, in *Becker I* has already ruled on the open meeting aspect of the litigation, and Becker had no absolute right to present an oral argument. All of the written materials submitted were sufficient to permit the Board to deny oral argument without abusing its discretion. *Arthur Lipper Corp. v. Securities and Exchange Commission*, 547 F.2d 171, 182 n.8 (2d Cir. 1976), *cert denied*, 434 U.S. 1009, 98 S.Ct. 719, 54 L.Ed.2d 752 (1978). Becker also argues that the Board received *ex parte* communications from Bankers Trust while it was deliberating on the Becker and SIA petitions. The Board proffers an affidavit of Rose L. Arnold, in charge of the Freedom of Information Office for the Board, who indicates that the material received from Bankers Trust was available for inspection in the public reading room of the Board. Its availability to Becker and to the public negates Becker's contention that this material (now a part of the administrative record, *see* R. at 476-550) was concealed or that the Board's receipt of such documents prejudiced Becker's rights.

A word need be added about the exact nature of the relief to be awarded plaintiffs. As previously noted, the law prohibits any court from affecting the issuance of a cease and desist order under 12 U.S.C. § 1818. The plaintiffs have indicated that the principal relief sought is a declaratory judgment that the Board's September 26, 1980 ruling that commercial paper is not a note or security under the Glass-Steagall Act is contrary to law. Such a judgment is within the province of this Court to award, and is attached herein. The Court expresses no opinion as to what steps, if any, may be taken following the issuance of this declaratory judgment.

Federal Reserve System

STATEMENT REGARDING PETITIONS
TO INITIATE ENFORCEMENT ACTION

The Securities Industry Association (the "SIA") and A.G. Becker, Incorporated ("A.G. Becker") have requested the Board to prohibit Bankers Trust Company, New York, New York ("Bankers Trust"), a State member bank, from selling commercial paper issued by companies not related to the bank ("third party commercial paper"). The SIA and A.G. Becker allege that Bankers Trust's sale of third party commercial paper violates the Glass-Steagall Act, which generally prohibits banks from underwriting or dealing in securities. A.G. Becker also contends that considerations of public policy militate against permitting Bankers Trust from selling third party commercial paper.

Bankers Trusts' Sales Activities

Commercial paper refers to prime quality, negotiable, usually unsecured short-term promissory notes issued by business organizations to meet part of their short-term credit needs.[1] Commercial paper is offered and sold to sophisticated purchasers, rather than to the general public, through dealers or directly by the issuer. Because commercial paper is usually unsecured, issuers are generally large, well-known, and financially strong businesses. Most commercial paper has an initial maturity of 60 days or less and the paper sold by dealers is issued in denominations usually ranging from $100,000 to $1 million or more. Purchasers of commercial paper are mostly large institutions with idle short-term funds to invest. Commercial paper is considered relatively risk-free; interest rates on

1 For a more detailed description of the commercial paper market *see* Hurley, The Commercial Paper Market, 63 Fed. Res. Bull. 525 (1977) [hereinafter cited as "Hurley"] and Comment, *The Commercial Paper Market and the Securities Acts*, 39 U. Chi. L. Rev. 362 (1972).

commercial paper are usually slightly above the rates on short-term United States government obligations, such as Treasury bills. The proceeds of commercial paper traditionally have been used for current or seasonal needs.

Bankers Trust represents that it is selling third party commercial paper only as the agent of the issuer and that the bank is not, like the commercial paper dealers, acting as a principal in such sales. Bankers Trust does not purchase, or make any commitment to purchase, the commercial paper the bank sells as agent. On some occasions, however, Bankers Trust extends credit (without any prior commitment), at or near the commercial paper rate, to issuers of paper sold by the bank in an amount representing a small portion of the unsold amount of the issue. The notes representing such loans may subsequently be sold. The bank's parent holding company has purchased for its own account commercial paper sold by the bank.[2]

Bankers Trust states that it does not tie the use of its other services to its commercial paper selling services and does not offer special inducements to issuers using such services. Bankers Trust sells only prime quality commercial paper of issuers that have the highest rating from at least one of the rating services that rate commercial paper issuers.

The customers to whom Bankers Trust sells commercial paper are usually part of Bankers Trust's established base of institutional investors that regularly purchase from the bank other short-term instruments in which the bank deals. Bankers Trust does not sell to individuals or to its trust department accounts.

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2 The bank also provides financial advice to issuers with regard to the issuance of commercial paper and serves as settlement agent for purchases of commercial paper. None of these activities has been directly challenged. Bankers Trust also sells as agent commercial paper issued by its own parent holding company. The Legal Division's analysis expressed no opinion on this activity and it is not involved in the present petitions.

The Glass-Steagall Act Issues

The Banking Act of 1933 contains four provisions (collectively referred to as the Glass-Steagall Act) that restrict participation by banks and affiliates of banks in specified securities activities. The provisions involved here are sections 16 and 21 of the Act, the provisions that apply to banks.[3] Section 16 provides in relevant part:

> The business of dealing in securities and stock by the [national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock. 12 U.S.C. § 24 Seventh.

Section 5(c) of the Glass-Steagall Act, 12 U.S.C. § 335, provides that State member banks are subject to the limitations of section 16 with respect to dealing in securities.

Section 16 carves out an exception to the general prohibition against involvement with securities by providing that national banks (and consequently State member banks) may purchase for their own account "investment securities" as defined in the statute.[4] "Investment securities" are defined by section 16 generally as marketable debt obligations commonly known as investment securities under such further definition prescribed by the Comptroller of the Currency. The Comptroller's regula-

3 Section 20 of the Act, 12 U.S.C. § 377, prohibits affiliates of banks from "engaging principally in the issue, flotation, underwriting, public sale or distribution" of securities. In addition, section 32 of the Act prohibits member banks from having director, officer, or employee interlocks with companies "primarily engaged" in the securities business.

4 Section 16 makes a further distinction with respect to investment securities. Banks may *underwrite* and *deal in* (as well as purchase for their own account) certain kinds of investment securities: obligations of the United States, general obligations of states or political subdivisions of states, and obligations of or guaranteed by certain government agencies.

tion, 12 C.F.R. § 1.3(b), defines "investment security" as a marketable debt obligation "commonly regarded as an investment security" and not "predominantly speculative in nature."

Section 21 of the Glass-Steagall Act provides that it is unlawful

> For any person, or . . . organization, engaged in the business of issuing, underwriting, selling, or distributing, . . . stocks, bonds, debentures, notes, or other securities, to engage at the same time . . . in the business of receiving deposits. 12 U.S.C. § 378(a)(1).

Section 21 further provides that its restrictions do not prohibit any bank from "dealing in, underwriting, purchasing, and selling investment securities, or issuing securities" to the extent such activities are permissible under section 16.

Thus, both section 16 and section 21 recognize a distinction between "investment securities" and other kinds of securities. Banks in general may invest in, *but not* underwrite or deal in (with limited exceptions), investment securities; banks are barred from issuing, purchasing for their own account, underwriting, or dealing in securities that do not qualify as investment securities.[5]

The contentions of the SIA and A.G. Becker that Bankers Trust is violating these statutory prescriptions are based on the contentions that (1) commercial paper is a "security" for purposes of the Glass-Steagall Act and (2) Bankers Trust's selling activities constitute the forbidden underwriting and dealing in securities. Additionally, the SIA and A.G. Becker claim that the selling of third party commercial paper gives rise to the kinds of abuses and hazards identified in the Supreme Court's 1971 analysis of the Act in *Investment Company Institute* v. *Camp*, 401 U.S. 617. The Securities and Exchange Commission ("SEC") has submitted to the Board the SEC's views on the issues raised by petitioners.

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[5] Under section 16, however, banks may perform certain *brokerage* activities—purchase or sale solely on the order of a customer—with respect to any securities.

A. *Commercial Paper as a "Security" under the Glass-Steagall Act*

The SIA, A.G. Becker, and the SEC advance three arguments in support of the claim that the commercial paper being sold by Bankers Trust is a "security" within the meaning of the Glass-Steagall Act: (1) commercial paper consists of marketable debt instruments and therefore constitutes an "investment security" as defined in section 16; (2) even if commercial paper is not an "investment security", commercial paper is a security because it consists of "notes" as specified in section 21; (3) commercial paper is a security for purposes of the Securities Act of 1933 and accordingly must be considered such for purposes of the Glass-Steagall Act, which was passed twenty days after the Securities Act.

Based on a review of all the relevant arguments and the facts of record, the Board is of the opinion that, as a legal matter, the stronger argument is that commercial paper is not a "security" within the intendment of the Glass-Steagall Act.

"*Investment securities*." In interpreting the meaning of the Glass-Steagall Act, the starting point must be the language of the statute itself.[6] Although each of the four Glass-Steagall Act provisions refers to activities with regard to "securities," none of these provisions, nor any other section of that Act, contains a precise definition of the term "securities." As noted above, however, both section 16 and section 21 create a distinction between investment securities—obligations that a member bank may purchase for its own account but in general may neither underwrite nor deal in—and other securities—obligations with which banks may have no involvement (except for permissible brokerage activities).

"Investment securities" are defined in section 16 as follows:

> *marketable obligations*, *evidencing indebtedness* of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures *commonly*

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6 *See, e.g., Transamerica Mortgage Advisers, Inc. v. Lewis*, 444 U.S. 11, 16 (1979).

> *known as investment securities under such further definition* of the *term . . . as may by regulation be prescribed by the Comptroller of the Currency.* 12 U.S.C. § 24 Seventh (emphasis added).

The Comptroller's implementing regulation defines investment security as "a marketable obligation in the form of a bond, note, or debenture *which is commonly regarded as an investment security*" that is not "predominantly speculative in nature." 12 C.F.R. § 1.3(b). (emphasis added).

The statutory language and the implementing regulation are clear: not all non-speculative, marketable debt obligations are "investment securities"; only those obligations that are *commonly known* or *regarded* as such qualify.[7] Consequently, the statute directs that the question of whether commercial paper constitutes an investment security be resolved only by resort to the common understanding of the nature of commercial paper by Congress, the regulatory agencies, and the banking industry.

The "investment securities" provision in section 16 did not originate in the Glass-Steagall Act, but in the prior provisions of the McFadden Act of 1927.[8] One of the purposes of the McFadden Act was to clarify the authority of national banks to deal in securities. At the beginning of this century, State chartered banks and trust companies, pursuant to liberal State legislation, became involved in a wide variety of investment banking functions, including the underwriting of debt and equity securities. National banks responded by expanding their activities to include the purchasing and selling—and underwriting and dealing in—not only municipal bonds but corporate bonds and stocks as well. *See* U.S. Department of the Treasury, Public Policy Aspects of Bank Securities Activities, App. 3-5 (1975). While the Comptroller permitted national banks to deal

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7 The contentions of the SIA and A.G. Becker that commercial paper is an investment security *merely* because such paper consists of marketable debt obligations ignore this plain language of the statute and the implementing regulation.

8 Pub. L. No. 639, ch. 191, 44 Stat. 1224.

in corporate debt,[9] there was no clear statutory authority for such activities. *Id.* In 1924, the Comptroller recommended legislation expressly to authorize national bank purchase and sale of investment securities.[10] The McFadden legislation followed in 1927.

Section 2 of that Act provided that the "business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse" marketable debt obligations commonly known as investment securities.[11] 44 Stat. 1226. This language was intentionally framed as a reaffirmance of the existing authority of national banks with respect to investment securities rather than as an affirmative grant of new power. *See* H.R. Rep. No. 83, 69th Cong., 1st Sess. 3-4 (1926). The legislative history, however, is clear that the authority codified or confirmed by the McFadden legislation with respect to investment securities did not apply to commercial paper. This is made plain by the remarks of Congressman McFadden, the sponsor of the legislation, during debate on the bill. Mr. McFadden indicated that commercial paper is not considered an investment security (and thus would not be subject to the restrictions of the Act) but is subject to the statutory limitations on loans to individual borrowers. 67 Cong. Rec. 3232 (1926).[12]

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9 The Comptroller, as well as the courts, strictly forbade, however, national bank involvement in underwriting and dealing in equity securities. *Id.*, at 2-3, 5.

10 Annual Report of the Comptroller of the Currency for 1924, at 12.

11 This power was, of course, later restricted somewhat by the Glass-Steagall legislation.

12 The relevant colloquy involving Congressman McFadden is as follows:

> Mr. WAINRIGHT. Let me ask the gentleman whether *commercial paper, as generally understood and accepted*, is regarded as *investment security*.
>
> Mr. McFADDEN. *No; it is not.* Commercial paper comes under the limitation of section 5200 in the Revised Statutes. I never have known of commercial paper being construed as investment securities. *Id.* (emphasis added).

The view of the framers of the McFadden Act that commercial paper should be treated as a loan rather than as a security is consistent with historical studies of the commercial paper market that indicate that banks purchased and sold commercial paper (and served as commercial paper dealers) pursuant to their lending functions long before commercial banks began expanding their activities into the underwriting of corporate bonds and other debt obligations after the Civil War, activities that were restricted by the McFadden legislation concerning investment securities and, six years later, by the Glass-Steagall Act. Thus, the commercial paper activities of commercial banks were viewed as an independent operation separate from the banking industry's subsequent involvement with investment securities.[13]

Furthermore, it has been the consistent and uniform practice of the bank regulatory agencies for almost 50 years to consider commercial paper as a loan, not as an investment security. For example, the Board took the view in 1933, in letters to the House Commerce Committee and the Senate Banking Committee commenting on the proposed securities legislation of

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13 *See generally* A. Greef, The Commercial Paper House in the United States (1938) [hereinafter cited as "Greef"]; N. Baxter, The Commercial-Paper Market (1964); M. Myers, The New York Money Market, Vol. I (1932). Greef found, for example, that before 1840 commercial banks in various parts of the country were purchasing and selling commercial paper and that dealings by banks in commercial paper could be traced back to the first commercial banks organized in the United States. Greef, *supra*, at 6-7, 15-18. Indeed, by 1900 commercial banks and savings banks purchased 95 per cent of the commercial paper sold, *id.*, at 96, and commercial paper was recognized as an important form of secondary reserves for the banking system. B. Beckhart, The New York Money Market, Vol. III 236-242 (1932). In addition to purchasing commercial paper as an investment, banks participated in the selling of such paper as dealers. Greef, *supra*, at 63, 403-405; R. Foulke, The Commercial Paper Market 108 (1931). In light of the longstanding and intimate relationship of banks with commercial paper, the views of the framer of the investment security legislation that commercial paper was not subject to its provisions are consistent with common banking practice at the time.

1933, that commercial paper, "short-time paper issued for . . . obtaining funds for current transactions" and purchased by banks and corporations with temporarily idle funds should not be considered an investment security. The Board stated that the proposed legislation was apparently intended to apply only to "investment securities, which are issued for . . . obtaining capital funds . . . and are purchased by persons for investment."[14]

Although the Comptroller of the Currency is delegated primary responsibility for fashioning a definition of the term, the Comptroller has never formally ruled on the status of commercial paper as an investment security for purposes of section 16. However, in a letter to a national bank in 1971, the Comptroller's Chief Counsel took the position that commercial paper represents a loan (subject to the statutory limits on loans) and does not constitute an investment security.[15]

The present attitude of the bank regulatory agencies is consistent with the view that commercial paper is properly viewed as a loan, not as an investment security. The instructions of each of the three federal banking agencies for preparation of call reports direct that commercial paper be treated as a loan. In addition, the Federal Reserve's manual of examination procedures follows the same position. In sum, based on the views of the framers of the investment securities provisions of section 16, of the banking industry, and of the regulators, the Board believes that commercial paper has not been, and is

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14 The Board's letters are reprinted in the hearings on the securities legislation. *Federal Securities Act: Hearing on H.R. 4313 before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 180-181 (1933); *Securities Act: Hearings on S. 875 before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 120 (1933).

15 Under an interpretation issued by the Comptroller, the statutory limits on loans to individual borrowers (12 U.S.C. § 84) are separate and distinct from the limit prescribed by section 16 of the Glass-Steagall Act on holding investment securities of a single issuer. 12 C.F.R. § 7.1180.

not, "commonly known" as an "investment security" and thus does not meet the statutory criteria for investment securities under section 16.

"Securities" other than "investment securities." Apart from the restrictions applicable to investment securities, sections 16 and 21 impose prohibitions with respect to securities in general. Section 16 generally prohibits dealing in "securities and stock." Section 21 states that depository institutions may not engage in the business of issuing or selling "stock, bonds, debentures, *notes* or other securities." (emphasis added). Since commercial paper conventionally consists of unsecured promissory notes, it may be argued that the term "notes" as used in section 21 is, under its usual meaning, broad enough to cover commercial paper. While the words in statutes should generally be interpreted in light of their ordinary meaning,[16] it is clear for a number of reasons that the term "notes" as used in section 21 should not be interpreted according to its literal sense. First, by its terms section 21 describes depository institutions (institutions that section 21 prohibits from issuing and selling "notes") as engaged in the business of receiving deposits evidenced by a "certificate of deposit or other evidence of debt"—instruments that themselves may be classified as "notes." Thus section 21 itself expressly permits banks to issue and sell certain kinds of notes—notes evidencing deposits. Second, the Glass-Steagall Act was plainly designed to keep banks from engaging in the investment banking business, not to prohibit banks from performing the traditional functions of banks.[17] Ordinary lending transactions are evidenced by notes

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16 *See, e.g., Perrin v. United States*, 444 U.S. 37, 42 (1979).

17 *See Investment Company Institute v. Camp*, 401 U.S. 617, 629 (1971) [hereinafter cited as "*ICI v. Camp*"]. Indeed the Supreme Court in the *Camp* case noted that commercial banks traditionally ". . . lend money, discount and negotiate promissory *notes* . . ." *Id.* (emphasis added). Indeed, if commercial paper were deemed to be a security other than an investment security, banks would be prohibited even from purchases of commercial paper for their own account, an activity that banks have long engaged in and continue to conduct. *See* Greef, *supra* note 13, at 96; Hurley, *supra* note 1, at 529.

and, in addition, banks commonly sell such notes to other lenders. It is evident that to view a note representing a bank loan as a security for Glass-Steagall Act purposes and, thus, the sale of such notes as an investment banking activity forbidden by the Act is completely at odds with the basic purpose of the Act. The rules of statutory interpretation do not require a literal reading of the term "notes" that would thwart the clear purpose of the Act and that leads to irrational results.[18]

Since the plain meaning of the statute cannot be dispositive of whether commercial paper is a security under the Glass-Steagall Act, it is appropriate to examine the history of the Act to attempt to resolve the question. It appears that Congress never adverted to bank involvement with commercial paper when it considered the Glass-Steagall legislation. There is, however, some indirect evidence that Congress did not view commercial paper, at least as the commercial paper market then existed, as the kind of obligation that would be subject to the Act. It is commonly agreed that the Glass-Steagall Act resulted from a number of specific abusive practices with respect to securities that had grown up in the banking industry. In particular, Congress was concerned about the risks and dangers to the banking system resulting from bank involvement with the "speculative operations" in securities characteristic of investment banking and with the practice of banks, begun in 1908, of establishing "security affiliates" that engaged, among other things, in underwriting bond and stock

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18 *See, e.g., Trans Alaska Pipeline Rate Cases*, 436 U.S. 631, 643 (1978). This approach has been taken by the courts in interpreting the definition of security in the securities acts, which generally define "security" to include "any note." The courts have not applied this language literally to bring all notes within the ambit of the securities laws but, on a variety of theories, have for the most part concluded that notes evidencing traditional lending transactions are not covered. *Exchange National Bank of Chicago* v. *Touche, Ross & Co.*, 544 F.2d 1126, 1131-1138 (2d Cir. 1976). *See generally United Housing Foundations, Inc.* v. *Forman*, 421 U.S. 837, 848-850 (1975).

issues. *ICI* v. *Camp*, *supra* note 17, 401 U.S. at 629-630, 632.[19] The Glass-Steagall bill was enacted only after extensive hearings on its provisions had been held in 1931 and 1932. Neither the Board nor the parties have been able to find any evidence of congressional concern about bank involvement with commercial paper. Morevoer, because at the time that the Glass-Steagall Act was being considered commercial banks purchased for their own account almost all of the commercial paper issued and commercial paper served as an important source of secondary reserves,[20] it may well be doubted that Congress could have been unaware of the extensive relationship then existing between the banking system and the commercial paper market.

Moreover, while there is no direct evidence in the legislative history of the Glass-Steagall Act on the status of commercial paper under the Act, there is evidence of contemporaneous statements by one of the draftsmen of the Act that commercial paper should not be considered a security. While the Glass-Steagall Act was pending before Congress in 1933, Congress was also considering the legislation that became the Securities Act of 1933. During Senate consideration of the securities bill, Senator Glass, the chief architect of the prohibitions against bank securities activities, proposed that short-term notes, including "9 months' commercial paper," be excluded from the definition of securities contained in that bill because to define such obligations as securities would "radically interfere" with "ordinary commercial banking transactions."[21] While Senator

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19 *See also Russell* v. *Continental Illinois National Bank & Trust Co.*, 479 F.2d 131 (7th Cir.), *cert. denied*, 414 U.S. 1040 (1973); *Baker, Watts & Co.* v. *Saxon*, 261 F. Supp. 247 (D.D.C. 1966), *aff'd sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968); *New York Stock Exchange, Inc.* v. *Smith*, 404 F. Supp. 1091 (D.D.C. 1975), *rev'd on other grounds*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 942 (1978).

20 *See* note 13 *supra*.

21 *Securities Act: Hearings on S. 875 before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 98 (1933).

Glass's proposed amendment was eventually adopted only as an exemption from some of the substantive provisions of the Securities Act,[22] his statements concerning the need for such an amendment strongly suggest that one of the principal draftsmen of the Glass-Steagall Act viewed commercial paper as closely linked to "ordinary commercial banking transactions" and not as involving the speculative investment banking functions that the legislation he sponsored was intended to restrain.[23]

In the course of administering the Glass-Steagall Act over the years the Board has not applied the Glass-Steagall Act prohibitions to the activities of banking organizations with respect to commercial paper. As noted above in the discussion of investment securities, the Board has traditionally viewed commercial paper purchased for a bank's own account as a loan, not as a security, for purposes of call reports. Furthermore, in its 1973 interpretation of the Glass-Steagall Act with respect to the sale of thrift notes (small denomination unsecured notes sold more or less continuously) by bank holding companies, the Board, while not expressly finding that commercial paper is not a security, stated that the issuance of commercial paper by a bank holding company "is not an activity intended to be included within the scope of section 20 of the Glass-Steagall Act." 12 C.F.R. § 250.221.

In addition to a review of the legislative history and agency interpretation, it is also appropriate to consider the status of commercial paper under the Act in light of the purposes for

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22 The effect of this action by Congress is discussed below.

23 The SEC argues that the testimony of Senator Glass is not persuasive because the Securities Act was enacted *before* the Glass-Steagall Act. Thus, according to the SEC, Senator Glass, if he really believed commercial paper was not a security, would have attempted, after a broad definition of "security" was adopted in the Securities Act, to amend the Glass-Steagall Act to exclude commercial paper. However, this argument assumes, without any support, that Senator Glass viewed the Securities Act definitions as germane to the Glass-Steagall Act.

which the Act was passed—to separate commercial and investment banking. As noted above with respect to the definition of "notes", a broad generic or literal reading of the term "security" would likely encompass a number of instruments that banks routinely deal with in the course of their business and would, consequently, be contrary to the basic purpose of the Act. On the other hand, a highly technical or formalistic approach might permit evasions of the mandate of Congress. However, it would seem that if a particular kind of financial instrument evidences a transaction that is more functionally similar to a traditional commercial banking operation than to an investment transaction, then fidelity to the purposes of the Act would dictate that the instrument should not be viewed as a security.

If such an approach is taken with respect to commercial paper, the Board believes that the stronger conclusion is that commercial paper currently being sold by Bankers Trust represents a financing transaction that is closer in function to commercial lending than to the sale of an investment. Historically, the dividing line between commercial and investment banking depended on whether short-term or long-term funds were being provided. As a short-term instrument, commercial paper fell on the commercial banking side of the line. Historical studies of the commercial paper market indicate that, as that market originated and developed, commercial paper was the functional equivalent of a bank loan. Commercial paper was used to raise funds for short-term needs and was sold almost exclusively to commercial banks.

It is clear, however, that the commercial paper market has changed somewhat in recent years. Most notably, commercial banks are no longer the predominant purchasers of commercial paper.[24] Nevertheless, the Board is of the opinion that, after a review of Bankers Trust's activities, the commercial paper currently being sold by the bank appears to evidence transactions that are more like commercial lending transactions than the sale of investments. First, the commercial paper sold

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24 *E.g.*, Hurley, *supra* note 1, at 529.

by Bankers Trust, like commercial paper generally, is a short-term instrument. While it may no longer be said that the provision of short-term credit to business is exclusively the function of banks, short-term loans continue to be the principal activity of commercial banks.[25] In addition, a typical commercial loan transaction involves a borrower and a single lender or, in the case of a loan participation, a relatively small number of lenders, that regularly extend credit as part of a business. Likewise, the purchasers of the commercial paper sold by Bankers Trust are relatively few in number and purchase paper in denominations larger than an average investor might be expected to afford. Moreover, it appears that most of the purchasers of the paper are part of the bank's base of institutional customers that purchase short-term obligations on a regular basis. These facts, in the Board's view, support the conclusion that the commercial paper currently being sold by Bankers Trust is more analogous to a commercial loan than to an investment. This view is consistent with the legislative history of the Glass-Steagall Act and the Board's general approach to commercial bank involvement with commercial paper. Accordingly, the Board believes that the stronger argument is that commercial paper should not be considered a security for the purposes of the Glass-Steagall Act.[26]

The Securities Act of 1933. The SIA, A.G. Becker, and the SEC argue that because commercial paper is a security for purposes of the Securities Act of 1933,[27] commercial paper

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25 While it is the practice of commercial paper issuers to reissue (roll over) paper at maturity, the purchasers of the paper, unlike the holders of bonds or other longer term instruments, have the legal right to demand payment at the original maturity date.

26 The Board's conclusion is limited to the obligations generally recognized as commercial paper: prime quality, negotiable, usually unsecured, promissory notes with maturities less than nine months that are exempt from the registration requirements of the Securities Act of 1933. The Board expresses no opinion with regard to the sale by a bank of third party obligations that do not meet these criteria.

27 Act of May 27, 1933, ch. 38, 48 Stat. 74.

must likewise be viewed as a "security" under the Glass-Steagall Act. Under section 2(1) of the Securities Act, 15 U.S.C. § 77b(1), the term "security" includes "any note." Section 3(a)(3) of that Act exempts from the registration and prospectus-delivery requirements of the Act any note the proceeds of which are used for current transactions and with a maturity of nine months or less. 15 U.S.C. § 77c(a)(3). Under sections 12(2) and 17(c), 15 U.S.C. §§ 77l(2), 77q(c), such short-term notes are not exempt from the antifraud prohibitions of that Act. Consequently, it is generally held that commercial paper is a security (albeit an exempt security) for purposes of the Securities Act.[28] The petitioners and the SEC contend that the Securities Act definition of "security" should be read into the Glass-Steagall Act because the two pieces of legislation address the same activities and were enacted within three weeks of each other in 1933.[29]

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28 *Franklin Savings Bank* v. *Levy*, 551 F.2d 521, 524 n.6 (2d Cir. 1977). With respect to the status of commercial paper under the other major federal securities law, the Securities Exchange Act, the question is not as clear. Unlike the 1933 Act, the 1934 Act expressly exempts commercial paper from that Act's *definition* of security. 15 U.S.C. § 78c(a)(10). The courts have not applied the exclusion literally, and courts have found that commercial paper is covered under the 1934 Act, at least where the particular commercial paper involved did not meet the criteria for exemption from registration under the 1933 Act, *e.g.*, the commercial paper was sold to the public. *Sanders* v. *John Nuveen & Co.*, 463 F.2d 1075, 1078-1080 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972).

29 Petitioners and the SEC rely on the legal analysis contained in a 1977 Board staff study of commercial bank private placements, which concluded that the definitions of "issue", "underwriter", and "distribution" in the Securities Act were "a compelling analogy" to the same terms employed in the Glass-Steagall Act. The Board has never formally reviewed the legal conclusions of the staff's private placement study. However, the private placement legal analysis does not necessarily contradict the position taken here. The private placement conclusions do not suggest that the definitions of the Securities Act are *conclusive*. In addition, the Board believes there is a distinction between definitions of activities carried on in the securities business and the definitions of a security, which are jurisdictional in nature and more closely linked to the purposes for which each Act was enacted.

While it seems clear that the definition of security in the Securities Act is relevant to a determination with regard to what instruments Congress thought were securities covered by the Glass-Steagall Act, it is the Board's opinion that the definition of security in the federal securities laws cannot be deemed conclusive for Glass-Steagall Act purposes. In the Board's view, this conclusion is supported by a number of arguments, but the most persuasive argument is that the definition of security under the Securities Act encompasses a variety of instruments that represent traditional banking functions and that to apply the prohibitions of the Glass-Steagall Act to such obligations would make illegal functions that clearly are properly part of the business of banking.[30] For example, a bankers' acceptance, like commercial paper, is a security under the Securities Act but exempt from registration. 15 U.S.C. §§ 77b(1), 77c(a)(3). However, commercial banks routinely purchase and sell bankers' acceptances and commercial banks (including Bankers Trust) serve as dealers in bankers' acceptances. Indeed, the Board determined as long ago as 1934 that bankers' acceptances were *not* securities under the Glass-Steagall Act.[31] To view the Securities Act definition of security as conclusive for Glass-Steagall purposes, as the securities industry representatives and the SEC suggest, would require that the traditional activities of commercial banks regarding bankers' acceptances be considered as the prohibited dealing in securities. This result is clearly contrary to the intent of the Glass-Steagall Act, which was not intended to restrict commercial banking functions. *ICI* v. *Camp*, *supra* note 17, at 629. In addition, although the courts are not unanimous, the

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30 It should also be noted that the Securities Act and the Glass-Steagall Act were not enacted to accomplish the same objectives. The Securities Act is an *investor* protection measure; the Glass-Steagall act is designed to protect *banks*, not investors. *Russell* v. *Continental Illinois National Bank & Trust Co.*, *supra*, note 19.

31 Letter, dated June 8, 1934, from the Secretary of the Board to the Federal Reserve Agent, Federal Reserve Bank of New York.

securities laws have in some cases been held applicable to certificates of deposits issued by banks,[32] passbook savings accounts,[33] loan participations,[34] and bills of exchange.[35] Under the theory advanced by the SIA, A.G. Becker, and the SEC, banks would be prohibited from issuing,[36] selling, or dealing in each of these instruments on the grounds that doing so is the prohibited business of investment banking. The Board does not believe such contentions are consistent with the purpose of the Act.[37]

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32 *Garner v. Pearson*, 374 F. Supp. 591, 596 (M.D. Fla. 1974).

33 *SEC v. First American Bank & Trust Co.*, 481 F.2d 673, 678 (8th Cir. 1973).

34 *Lehigh Valley Trust Co. v. Central National Bank of Jacksonville*, 409 F.2d 989, 991-992 (5th Cir. 1969).

35 *MacAndrew & Forbes Co. v. American Barmag Corp.*, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,532 (D.S.C. 1972).

36 The SEC states that considering time deposits as securities under the Glass-Steagall Act would not disrupt the statutory scheme of that Act because the Act does not prohibit a bank from issuing its *own* securities—only dealing in or underwriting the securities issued by *others*. However, section 21 plainly prohibits banks from engaging in the business of "issuing" and "selling" securities and does not limit such securities to those of third parties. While Board staff has taken the position that a bank's occasional issuance of its own stock, bonds, or debentures (an activity essential to the viability of the organization) does not constitute being engaged "in the business" of issuing securities under section 21, it seems clear that banks issue and sell time deposits, bankers' acceptances, and similar instruments as a regular part of their "business" and, if such instruments are considered securities for Glass-Steagall Act purposes, banks would be prohibited by the Act from such activities.

37 The Board expresses no opinion regarding the legal status of the commercial paper sold by Bankers Trust under the Securities Act of 1933 or under any other law except the Glass-Steagall Act. It is noted, however, that commercial paper has been held to be a security for at least some purposes under the federal securities laws. *See* pages 20-21, *supra*.

Because of the historical involvement of the banking industry with commercial paper, the nature of the commercial paper currently sold by Bankers Trust, and the fact that commercial paper is exempt from the substantive obligations of the Securities Act of 1933 (except for the antifraud provisions), the Board concludes that, notwithstanding the status of commercial paper as an exempt security under the Securities Act, the stronger argument is that commercial paper is not a security for purposes of the Glass-Steagall Act.

B. *Bankers Trust's Activities as Dealing in or Underwriting Securities*

Since, in the Board's opinion, the stronger argument is that commercial paper should not be treated as a security covered by the Glass-Steagall Act, the restrictions of the Act with regard to issuing, underwriting, selling, and dealing in securities do not apply. Thus, it is not necessary to reach the issue of whether the activities engaged in by Bankers Trust are prohibited by the Act.

C. *Policy Concerns Behind the Glass-Steagall Act*

The SIA, A.G. Becker, and the SEC also assert that the selling of commercial paper by Bankers Trust produces the same kinds of risks to the bank and potential for conflicts of interest that Congress intended to eliminate in enacting the Glass-Steagall Act. In its opinion on the Glass-Steagall Act in *ICI* v. *Camp*, *supra* note 17, the Supreme Court analyzed the scope of the Act in terms of specific "hazards" and "financial dangers" that Congress had in mind when banks engaged in activities prescribed by the Act. 401 U.S. at 630.

At the outset, the Board notes that since the stronger view is that commercial paper should not be considered a security for Glass-Steagall Act purposes, the sale of commercial paper by Bankers Trust is not prohibited by the specific terms of that Act. Accordingly, it does not appear necessary to examine the dangers that the Act was intended to eliminate.[38] Nevertheless,

38 *See Aaron* v. *SEC*, 100 S. Ct. 1945, 1955 (1980).

the Board believes that the sale of third party commercial paper by a commercial bank could involve, at least in some circumstances, practices that are not consistent with principles of safe banking.[39] Thus, the Board, in cooperation with the other federal bank regulatory agencies, has initiated the process of developing guidelines governing the sale of third party commercial paper by a commercial bank designed to prevent potential unsafe or unsound practices that could arise in such an activity. When these guidelines are developed and submitted to the Board for consideration, the Board will address in that proceeding the general issues raised by the allegations of petitioners and the SEC relating to potential undue risks to banks or conflicts of interest arising from this activity.

Public Policy Considerations

A.G. Becker advances a number of public policy considerations that it claims militate against permitting a commercial bank to sell third party commercial paper. A.G. Becker first asserts that a full-service commercial bank selling commercial paper enjoys unfair competitive advantages over nonbank sellers because banks would be able to offer a package of services to an issuer of commercial paper that the nonbank seller could not offer. A.G. Becker also cites the potential for predatory pricing, access as settlement agent to the customer lists of competing sellers, and the cut-off of credit to nonbank sellers of commercial paper.[40] The Board's review of Bankers Trust's current operations in selling commercial paper has not uncovered any evidence at this time of such alleged unfair competitive practices.

It is next claimed that persons classified as "brokers" under the Securities Exchange Act of 1934 are subject to a number of

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39 *See* 12 U.S.C. § 1818(b).

40 A.G. Becker claims that the asserted advantages constitute "unfair practices" by banks under section 18(f) of the Federal Trade Commission Act and the Board's Regulation AA. 12 C.F.R. § 227.

regulatory requirements designed to protect investors and that banks (which are exempt from the definition of broker in the Securities Exchange Act) are not subject to similar restrictions. However, since commercial paper is exempted from the definition of security in the Securities Exchange Act,[41] it would appear that a nonbank seller of commercial paper is not subject to the provisions of that Act if commercial paper is the only instrument sold. In any event, commercial banks are subject to certain investor protection requirements in connection with their securities transaction activities similar to those imposed on nonbank brokers. *E.g.*, C.F.R. § 208.8(k). Moreover, Bankers Trust sells commercial paper only to sophisticated institutional investors that would appear to be less in need of many of the safeguards designed to protect average investors.

Finally, A.G. Becker claims that if commercial banks become dominant in the commercial paper market, the resulting competition may reduce the efficiency of the securities industry and impair the capital-raising mechanism provided by that industry. Presently, however, Bankers Trust is by no means dominant in the commercial paper market and there is no available evidence of disruption of the capital markets as a result of Bankers Trust's activities. Accordingly, the Board believes that the policy considerations advanced by A.G. Becker do not at this time warrant prohibition of Bankers Trust's selling of third party commercial paper.

In summary, the Board has determined to deny the petitions of the SIA and A.G. Becker to the extent such petitions allege that Bankers Trust's commercial paper activities violate the Glass-Steagall Act or that such activities should be prohibited by general considerations of public policy. The Board is taking no action regarding petitioners' contentions of dangers to Bankers Trust and potential conflicts of interest and will consider these issues in the context of the Board's consideration of guidelines governing the sale of third party commercial paper by commercial banks.

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41 15 U.S.C. § 78c(a)(10).

Request for Oral Argument

Counsel for A.G. Becker has requested the opportunity to present oral argument to the Board when this matter is submitted to the Board for consideration. However, the Board as yet has initiated no agency proceedings in connection with Bankers Trust's commercial paper activities and A.G. Becker is not a party to any agency proceeding pending before the Board. The Board notes that counsel for A.G. Becker has met with the Board's staff on at least two occasions concerning the activities of Bankers Trust. Moreover, the Glass-Steagall Act issues resolved by the Board are essentially legal in nature and all the interested organizations have submitted extensive written arguments on these issues. In the Board's view, these written submissions adequately explain the issues involved and oral argument before the Board at this time would serve no useful purpose. Accordingly, the request by A.G. Becker for oral argument before the Board on this matter is denied.

Federal Reserve System

POLICY STATEMENT CONCERNING THE SALE OF THIRD PARTY COMMERCIAL PAPER BY STATE MEMBER BANKS

[Docket No. R-0360]

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Policy Statement

SUMMARY: Pursuant to its authority to restrain unsafe or unsound banking practices by State member banks, the Board of Governors of the Federal Reserve System adopts a policy statement setting forth guidelines governing the sale by a State member bank of commercial paper of issuers not related to the bank ("third party commercial paper"). The guidelines reflect the Board's judgment that certain practices may develop in the sale by a bank of third party commercial paper that may not be consistent with the principles of safe and sound banking. The guidelines concern the type and amount of commercial paper that should be sold, the kinds of records that should be maintained, and the purchasers to which such paper may be sold. The Board intends to monitor closely the activities of State member banks in this area and may modify or supplement this policy statement based on the Board's review of the experience of State member banks in conducting these activities.

EFFECTIVE DATE: May 26, 1981. Interested parties may submit comments on the policy statement that will be reviewed by the Board. Comments must be received on or before July 31, 1981.

ADDRESS: Comments should include reference to Docket No. R-0360 and should be mailed to the Secretary, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue, N.W., Washington, D.C. 20551, or delivered to Room B-2223, 20th and Constitution Avenue, N.W., Washing-

ton, D.C. between 8:45 a.m. and 5:15 p.m. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m.

FOR FURTHER INFORMATION CONTACT: Robert S. Plotkin, Assistant Director, Division of Banking Supervision and Regulation, (202) 452-2782, or Richard Ashton, Senior Counsel, Legal Division, (202) 452-3750, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTAL INFORMATION: On September 26, 1980, the Board took action with respect to the petitions of the Securities Industry Association (the "SIA") and of A.G. Becker Incorporated ("A.G. Becker") that the Board prohibit Bankers Trust Company, New York, New York ("Bankers Trust"), a State member bank, from selling third party commercial paper. The Board denied the petitions to the extent they alleged that Bankers Trust's commercial paper activities violate the Glass-Steagall Act or should be prohibited by general considerations of public policy. The Board also stated that the sale of third party commercial paper by a commercial bank could involve, at least in some circumstances, potential unsafe or unsound practices. The Board thus took no action on the petitions' allegations of dangers to Bankers Trust or potential conflicts of interest pending development of general supervisory guidelines designed to avoid potential unsafe or unsound practices in the sale of third party commercial paper by State member banks.

In developing the guidelines that are set forth in the following policy statement, the Board has consulted with the staffs of the other federal banking agencies and has considered the allegations of unsafe practices made by the SIA and A.G. Becker and the comments of the Securities and Exchange Commission.

With respect to the possibility that a bank's commercial paper selling activities may lead the bank into investing its funds in imprudent investments, the Board recognizes that a bank's selling activity may result in the purchase of some commercial paper with the bank's own funds. However, the Board notes that banks have traditionally been permitted to purchase commercial paper for their own account and such

purchases have been treated for supervisory purposes as commercial loans. In addition, since only large, well-known corporations with established credit ratings are able to market unsecured obligations, commercial paper is generally a low-risk instrument, even relative to some commercial loans.[1] Furthermore, the Board's guidelines provide that a bank should sell only prime quality paper and make a thorough credit analysis of each issuer and that all commercial paper sold by the bank should be fully supported by available lines of credit.[2] These guidelines would also minimize the danger that a bank selling commercial paper might be tempted to make unsound loans to an issuer which is encountering financial difficulties in order to protect the bank's reputation.

The SIA, A.G. Becker, and the SEC have also raised the possibility of loans by a selling bank to facilitate purchase of commercial paper being sold by the bank. However, because rates on commercial paper are usually lower than rates charged on bank loans, the use of borrowed funds to purchase commercial paper would be unprofitable and thus unlikely. Accordingly, there does not appear to be any practical substance to this concern.

Another potential hazard cited in connection with bank sales of commercial paper is the possibility that the bank's salesman's interest might impair its existing obligations to its customers and might consequently damage the bank's good will and reputation. In particular, it is claimed that bank depositors might suffer losses on paper purchased from the bank, that "the bank's reputation for prudence and restraint would be abused," that the bank would lose its ability to provide disinterested investment advice, and that the bank

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1 The Board notes that, at least on some occasions, significant losses have been suffered by commercial paper purchasers, for example, the 1970 collapse of Penn Central Transportation Company. However, banking functions, such as commercial lending, also involve some degree of risk and losses can and do occur.

2 A selling bank could only participate in the line of credit up to the amount of its legal lending limit.

might "unload" worthless commercial paper in its trust department.

Under the Board's guidelines, however, a bank may sell commercial paper only to financially sophisticated purchasers and may not advertise commercial paper for sale to the general public. Thus, there appears to be little likelihood that any but a small fraction of a bank's depositors would even consider purchasing commercial paper being sold by the bank. For the same reason, the potential for a bank abusing its reputation for "prudence and restraint" in selling commercial paper does not appear significant. Finally, with respect to potential inability to provide disinterested investment advice and "unloading" of worthless commercial paper in the bank's trust accounts, the guidelines provide that the bank should not sell commercial paper to fiduciary accounts over which the bank has investment discretion.

The Board intends to monitor closely the selling activities of Bankers Trust and any other State member bank that may initiate such services. Based on further experience in this area, the Board may modify or supplement these guidelines to assure that such activities are conducted in accordance with principles of safe and sound banking.

Accordingly, acting pursuant to its supervisory authority over State member banks contained in section 9 (12 U.S.C. 321, *et seq.*) and section 11 (12 U.S.C. 248) of the Federal Reserve Act and the Financial Institutions Supervisory Act of 1966 (12 U.S.C. 1818(b)) and related provisions of law, the Board of Governors adopts the following policy statement.

Policy Statement Concerning Sale of Third Party Commercial Paper by State Member Banks

The Board of Governors has recently determined that the sale of commercial paper by a State member bank for unaffiliated issuers ("third party commercial paper")[3] did not violate

[3] Excluding commercial paper issued by a parent bank holding company; the Board has previously advised bank holding companies concerning sales of bank holding company commercial paper (letter dated June 27, 1980).

the Glass-Steagall Act (12 U.S.C. §§ 24, Seventh, 378). The Board was concerned however, that the sale of third party commercial paper[4] might, in some circumstances, involve unsafe or unsound practices. Accordingly, in the interest of safe and sound banking, the Board believes that any State member bank that may decide to engage in the sale of third party commercial paper should adhere to the following guidelines.[5]

1. A State member bank should sell only prime quality commercial paper that qualifies for the exemption provided by section 3(a)(3) of the Securities Act of 1933 (15 U.S.C. 77c(a)(3)). The bank should take appropriate precaution to assure itself that the section 3(a)(3) exemption applies to the commercial paper it proposes to sell. In this regard, (i) the bank should determine that the commercial paper it proposes to sell is of prime quality; (ii) the bank may rely on representations of the issuer with respect to the use of proceeds; (iii) except as further limited by paragraphs 7 and 8, the bank should sell commercial paper only to financially sophisticated customers, such as customers that regularly purchase a variety of short-term credit instruments, and should not advertise commercial paper for sale to the general public; (iv) the bank should obtain periodically, and maintain in the bank's records, a current legal opinion of counsel that the section 3(a)(3) exemption is available. In addition, the bank should sell commercial paper in minimum denominations that are consistent with applicable law and, in no event, should sell commercial paper in minimum denominations of less than $100,000.

2. The selling bank should maintain a complete credit analysis of the issuer at all times and should exercise due diligence

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4 Banks have traditionally purchased commercial paper upon the order, and for the account of, customers, whereas here the bank is essentially acting for the issuer; the former activity is not subject to the guidelines set forth in this Policy Statement.

5 The Board does not expect to take enforcement action to restrain unsafe or unsound banking practices with respect to third-party commercial paper selling activities of any State member bank that conducts such activities within these guidelines.

in investigating the financial affairs of the issuer. Particular attention should be given to the liquidity position of the issuer and its lines of credit. All commercial paper sold by the bank should be fully supported by available lines of credit. Any participation by the selling bank in such lines of credit should be made only after consideration of the bank's legal lending limit.

3. Senior management should adopt internal limits for the amount(s) of commercial paper that may be sold by the bank for a single or related issuer(s). In determining the internal limits, senior management should consider the financial condition of the issuer, all lines of credit available to the issuer, and the bank's participation in the lines of credit and any other extensions of credit or commitments to the issuer by the bank (including commercial paper purchased by the bank for its own account.)

4. Chronological records of original entry should be maintained that contain an itemized daily record of all sales and purchases of commercial paper. The records should also contain:

- A designation of the commercial paper,
- nature of the transaction, *e.g.* purchase or sale,
- trade and settlement dates,
- contra-party name or designation,
- net proceeds, discount rate, or yield to maturity.

5. Account records should be maintained for each issuer that reflect:

- All sales and purchases of commercial paper placed by the bank for that issuer,
- all lines of credit available to the issuer,
- the amount of the bank's participation in the lines of credit,
- a current balance of all extensions of credit and a description of other commitments to the issuer.

6. Account records should be maintained for each purchaser that reflect all sales and purchases of commercial paper for the account of that customer.

7. Commercial paper should not be sold to fiduciary accounts over which the bank has investment discretion.

8. Commercial paper should not be sold to the bank's parent holding company (unless it is a bank) or any nonbank affiliate of the bank.

9. The bank should furnish to all purchasers of commercial paper written advice in connection with all purchases that (1) the commercial paper is not an obligation of the bank, and is not insured by the FDIC, (2) the bank has no obligation to repurchase any of the paper sold, (3) the bank is under no obligation to lend funds to the issuer (except pursuant to existing credit lines, or other commitments, if any), and (4) copies of the issuer's most recently published financial statements will be furnished upon request.

By order of the Board of Governors, May 26, 1981.

(signed) James McAfee

James McAfee
Assistant Secretary of the Board

(SEAL)

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 80-2258, 81-1493, 81-2070, 81-2096,
80-2314 and 81-2058

February 2, 1983

A.G. BECKER INCORPORATED,
Petitioner,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,
Respondents.

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,
Respondents.

Before:

TAMM and WILKEY, *Circuit Judges*,
and ROBB, *Senior Circuit Judge*.

ORDER

On consideration of the joint petition for rehearing of A.G. Becker, Inc. and the Securities Industry Association, filed December 17, 1982, it is

ORDERED by the Court that the aforesaid petition is denied.

Per Curiam

For The Court

GEORGE A. FISHER, *Clerk*

By: Robert A. Bonner
Chief Deputy Clerk

Senior Circuit Judge Robb did not participate in the foregoing order.

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—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, ET AL.,

Respondents.

Before:

ROBINSON, *Chief Judge*, WRIGHT, TAMM,
MACKINNON, WILKEY, WALD, MIKVA, EDWARDS, GINSBURG,
BORK and SCALIA, *Circuit Judges*.

ORDER

The joint suggestion for rehearing *en banc* of A.G. Becker, Inc. and the Securities Industry Association has been circulated to the full Court. A majority of the Court has not voted in favor thereof. On consideration of the foregoing, it is

ORDERED by the Court *en banc* that the aforesaid suggestion is denied.

Per Curiam

For The Court

GEORGE A. FISHER, *Clerk*

By: Robert A. Bonner

Circuit Judges MacKinnon and Mikva would grant the suggestion for rehearing *en banc*.

Chief Judge Robinson and Circuit Judges Wald, Ginsburg and Bork did not participate in the foregoing order.

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